
United States Circuit Court of Appeals

For the Ninth Circuit

J. P. DUKE, as Supervisor of Banks of the
State of Washington, and as Successor in
Office of the Defendant CLAUDE P. HAY,
as State Bank Commissioner of the State of
Washington, FORBES P. HASKELL, JR.,
as special Deputy Supervisor of Banks of
the State of Washington, and SCANDINA-
VIAN AMERICAN BANK OF TACOMA,
a Corporation,

Appellants,

vs.

McCLINTIC-MARSHALL COMPANY, a
Corporation, et al.,

Appellees,

No. 3953

Brief of Appellants

UPON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE WESTERN
DISTRICT OF WASHINGTON, SOUTH-
ERN DIVISION.

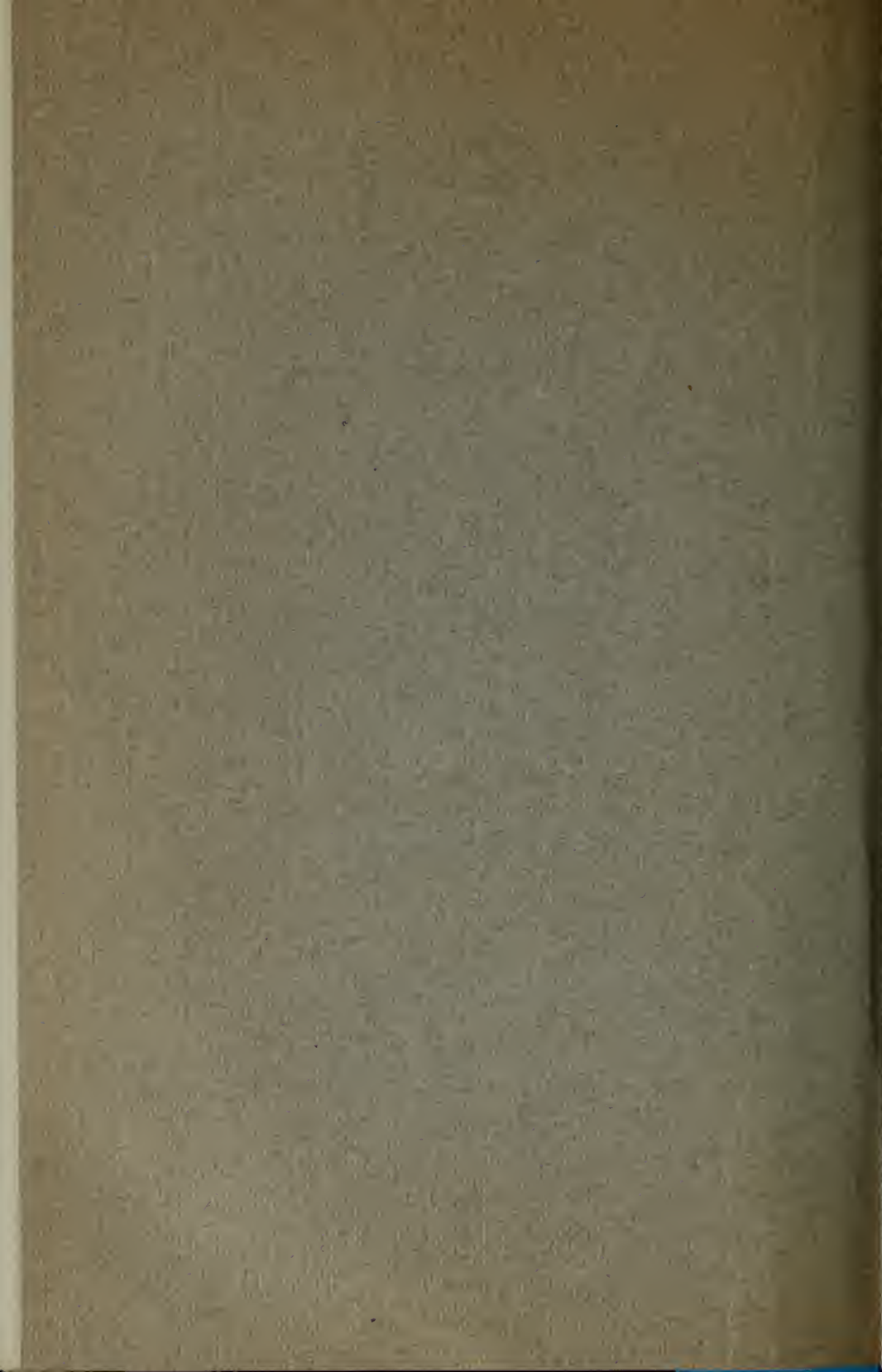
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U. S. DISTRICT COURT
TACOMA, WASH.



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ERN DIVISION.

STATEMENT OF THE CASE.

This controversy arises between lien claimants claiming priority for their liens upon certain real property situated in the City of Tacoma on the one hand and the Supervisor of Banking of the State of

Washington, an official of the State of Washington appointed by the Governor as liquidator of the defunct Scandinavian American Bank of Tacoma on the other. The particular questions involved are

First: Whether or not two mortgages held by the Supervisor are valid.

Second: Whether or not these mortgages are superior to the liens.

The facts with reference to these two mortgages are entirely different and are therefore separately stated.

THE \$70,000.00 MORTGAGE—FIRST MORTGAGE.

The Scandinavian American Bank of Tacoma failed and was taken over for liquidation by the State of Washington on January 15, 1921.

This mortgage was not among the assets of the defunct bank when it failed, but was at that time owned by the Penn Mutual Life Insurance Company, the mortgagee therein named, which company was not made a party in the original complaint filed herein. It was, however, purchased by the Supervisor of Banking of the State of Washington after the institution of this action.

This defunct bank was incorporated prior to 1910. It was desirous of purchasing the six-story office building located on the corner of South 11th Street and Pacific Avenue, in the City of Tacoma, upon two lots designated as lots 11 and 12 in block 1003,

“Map of New Tacoma”. The bank did not want to invest more money in this building than necessary and did not want to carry any liability upon its books of account for the balance of the purchase price remaining unpaid (Tr. p. 1134), so the property was deeded to J. E. Chilberg, its president (Ex. 322, Tr. p. 1188), on September 1, 1910; on September 2, 1910, Chilberg and his wife gave the Penn Mutual their note for \$100,000.00 (Ex. 234, p. 1143), secured by the mortgage in question covering this property (Ex. 326, p. 1195 *et seq.*), accompanied by an affidavit of good faith, as required in the case of Chattel Mortgages in Washington, since the mortgage covered the fixtures and other personal property (Ex. 324, Tr. p. 1192), and on January 12, 1911, Chilberg and his wife reconveyed the property to the bank subject to this mortgage and another mortgage immaterial in this action, but the *bank did not assume the mortgage or agree to pay it.* (Ex. 323, Tr. p. 1190). This mortgage by its terms was payable on September 1, 1915, and at that time the Penn Mutual, the Chilbergs and the bank entered into an agreement, which was placed of record in Pierce County, whereby the mortgage was extended so that \$30,000.00 was payable on or before September, 1919, and the balance—\$70,000.00—became payable September 1, 1920; this agreement contains the following clause (Ex. 327, Tr. p. 1204 and pp. 1208-9):

"It being understood, however, that said Scandinavian American Bank of Tacoma does not itself assume any personal obligation to pay the indebtedness secured by said mortgage, the only personal obligation to pay said indebtedness secured by said mortgage being the personal obligation of J. E. Chilberg and Anna Chilberg, his wife."

This mortgage and agreement were duly placed of record and remained of record unaffected by any other instrument until after the failure of the bank and the institution of this action.

In the year 1919, O. S. Larson, the active head of this bank, decided that the six-story building was old and dilapidated and no longer a fitting habitation for his prosperous bank (Tr. p. 1040) and that a sixteen-story building was desirable. He got in touch with a bond broker, G. Wallace Simpson, who arranged with Strauss & Co. for a loan of \$900,000 with which to build this building. He also got in touch with an architect, Frederick Webber, of Philadelphia. The directors of the bank were not a unit on the proposition—at that time Larson wrote Simpson as follows (Ex. 199, p. 1052-1054):

"As stated in this telegram three of our board of directors are offering very serious objection to the large loan of \$900,000.00 unless the equity which the bank would own in the property could be sold outright *to the building corporation*, so that finally the only interest the bank would have in the property would be a lease on the banking room and

basement for, say, a period of twenty-five years, at an increased rental every five years, if desired."

The words which we have italicised show that it was even then the intention to form a corporation for the purpose of building, owning and operating this proposed building, and that it was further the intention that the bank, as such, should not only not invest its money in this project, but should actually receive all or nearly all it had put into the property.

At that time, too, Mr. Moore, then the Bank Commissioner of the State, was evidently objecting to the project, since Chilberg wrote to Larson under date of August 6, 1919, as follows (Ex. 202, p. 1058):

"I have been thinking over your conversation with Moore last night. I do not think I would worry that fellow any more anyway. His head is certainly thicker than mush.

"If you get your building financed and need the extra \$150,000, put it on a second mortgage; give us (The Scandinavian American Bank of Seattle) one-half or two-thirds of it here and you carry the balance, and there is no one in the United States to kick unless it would be your stockholders or ours, and it is for their interests that we would be doing it."

To which Larson replied, under date of August 16 (Ex. 203, pp. 1059-60), outlining his scheme for financing the building, in which he states that the bank was to be paid \$350,000.00 for its old building; the "Drury lot", namely, the adjoining lot, was

to be purchased for \$60,000.00 and the new building erected at a cost of \$790,000.00, making a total outlay of \$1,200,000.00, which was to be raised by a first mortgage to net \$712,500.00, leaving \$487,500.00 to be raised on a second mortgage and in capital stock. This letter contains this clause:

“I have instructed our attorneys to incorporate immediately a corporation to be known as the 11th Street Improvement Company or some other suitable name. This corporation will purchase the property from the bank and Drury, construct the building and operate it.”

On August 24th, Simpson wired the terms of the proposed Strause Loan, which would net the building corporation \$810,000, and it was in the conference over this wire that the board of directors of the bank insisted that the bank, as such, get its equity in cash for the property to be conveyed to the building corporation (Ex. 199, p. 1052, *et seq.*)

In accordance with the suggestions contained in this letter, George G. Williamson, the bank's attorney and one of its directors, Mr. Thompson, another director, and Larson met in September in New York City with Simpson and Webber and it was decided to refuse the Strauss loan, and Larson then opened negotiations with the Metropolitan Life Insurance Company in New York City for a loan (Tr. 1041) and received a letter from that company by which it tentatively agreed to loan \$650,000.00 on the building when it was completed. (Ex. 193, p. 1037

et seq.). This was followed by another letter, dated November 7, 1919, which is referred to as the "Metropolitan Commitment", wherein it was definitely stated that if the building was completed in accordance with plans then furnished by Webber the company would loan \$600,000.00 on it when completed. (Ex. 177, Tr. p. 981 *et seq.*).

The court will notice that this last letter was addressed to "Scandinavian American Building Company".

Notwithstanding all this conclusive evidence Larson testified that the bank contemplated the erection of this building, that it was understood that the bank's money was to build the building and that the formation of a separate corporation was first suggested by Mr. Moore in October of 1919 "to limit the liability for damage suits, bills and other things on that building."

The Scandinavian American Building Company was organized on November 18, 1919; Larson subscribed for all but four shares of its stock and Lindberg, Drury, Williamson and Lindeberg each subscribed for one share. The stock was of the par value of \$100.00 (Ex. 179, p. 985 *et seq.*; Ex. 178, p. 1256).

Lot ten adjoining the two lots above described and referred to as the "Drury lot" was deeded to the building company by warranty deed, date November 10, 1919, but the deed was not delivered until Feb. 9, 1920 (Ex. 332, p. 1251 *et seq.*).

On February 25, 1920, the bank conveyed to the building company the title to the two lots upon which the old building stood by warranty deed (Ex. 325, p. 1194). This transaction, as authorized by the trustees of the bank, is set forth in the minutes of the directors' meeting of the bank and in a certificate delivered to the bank by the building company. The bank minutes are found in Exhibit 181 (Tr. p. 1005 *et seq.*), and contain the following record of the transaction:

Mr. Drury presided and called the meeting to order and a quorum being present, the following business was transacted:

The Board next considered the matter of the transfer of the property owned by the Bank, being its former site and described as:

Lots 11 and 12, in Block 1003,
"Map of New Tacoma, W. T."

to the Scandinavian American Building Company. This property being encumbered with a mortgage in the principal sum of \$70,000, and the Scandinavian American Building Company having acquired lot 10 adjoining, proposes to erect a sixteen-story office building upon the three lots and for the purpose of financing the erection of said building, proposes to borrow \$600,000, and execute therefor a first mortgage upon said premises and in addition thereto to issue second mortgage bonds against said premises in the principal sum of \$750,000, bearing interest

at 6 per cent per annum, payable semi-annually and running for a period of fifteen (15) years and in order to make the proper financial arrangements, it will be necessary that the title to said premises be vested in said Scandinavian American Building Company and the first mortgage placed against said premises before any work or construction of the building shall commence and before any contract shall have been let for the erection or construction of said building, and the Scandinavian American Building Company agreed to execute to the bank a temporary agreement or certificate, by the terms of which it agrees to execute and deliver to this bank, second mortgage bonds of the par or face value of \$350,000 in payment for said premises, such bond issue to be for not in excess of \$750,000, bearing interest at 6 per cent per annum, payable semi-annually and to run for a period of fifteen (15) years and to contain a provision to the effect that the income from said bonds shall, up to two (2%) per cent of the par value of such bonds, be tax free. After discussion, the following resolution was offered and its adoption was moved by Mr. Larson, seconded by Mr. Lindberg and carried, to-wit:

WHEREAS, the SCANDINAVIAN AMERICAN BANK OF TACOMA is the owner of lots 11 and 12 in block 1003, in "Map of New Tacoma, W. T." situated in Pierce County, Washington, which property is at the present time encumbered by a mortgage in the principal sum of \$70,000, and

WHEREAS, SCANDINAVIAN AMERICAN BUILDING COMPANY, a corporation, organized under the laws of the State of Washington, has proposed to purchase said property for the consideration of \$350,000 and proposes to erect upon said premises and lot 10 adjoining, a modern office building of approximately sixteen stories in height and to provide the ground floor thereof with space and accommodations for a Metropolitan banking institution, which space shall be reserved for the use of this bank upon a rental to be agreed upon, and

WHEREAS, for the purpose of financing the construction and erection of said building, the following arrangement has been entered into by said SCANDINAVIAN AMERICAN BUILDING COMPANY, to-wit:

A first mortgage for the principal sum of \$600,000, to be executed by said SCANDINAVIAN AMERICAN BUILDING COMPANY, upon all three lots, which said mortgage must be executed and recorded before actual construction shall begin and before any contract for such construction shall have been let and a series of second mortgage bonds of the total par value of \$750,000, to be executed and secured by a second mortgage on said premises, which said bonds shall run for a period of fifteen (15) years and bear interest at 6 per cent per annum, payable semi-annually and contain a covenant exempting the income thereof equal to 2 per cent of the total par value of said bonds exempt

from taxation by the Federal Income Tax Laws, and

WHEREAS, said SCANDINAVIAN AMERICAN BUILDING COMPANY cannot execute said first mortgage or said second mortgage and the bonds to be secured thereby until it shall first have acquired title to said premises, and

WHEREAS, said SCANDINAVIAN AMERICAN BUILDING COMPANY has agreed to execute and deliver to SCANDINAVIAN AMERICAN BANK OF TACOMA second mortgage bonds hereinbefore referred to of the par value of \$350,000 in payment for said real estate as soon as the same can expediently be prepared and be a second mortgage lien upon said premises, and

WHEREAS, temporarily, said SCANDINAVIAN AMERICAN BUILDING COMPANY will execute a certificate or agreement agreeing to so deliver said bonds as soon as the same can be executed as above provided,

NOW, THEREFORE, BE IT RESOLVED, that the President and Cashier of SCANDINAVIAN-AMERICAN BANK OF TACOMA be and they are hereby authorized, directed and empowered to execute and deliver to said SCANDINAVIAN-AMERICAN BUILDING COMPANY a warranty deed of conveyance to said lots 11 and 12, in block 1003, "Map of New Tacoma, W. T." upon receiving from said SCANDINAVIAN-AMERICAN BUILDING COMPANY a certificate or agreement agreeing to

deliver to said SCANDINAVIAN-AMERICAN BANK OF TACOMA, within four (4) months from the date hereof, bonds of the par value of \$350,000, bearing interest at 6 per cent per annum, payable semi-annually and running for a period of fifteen (15) years, which said bonds shall be secured by a second mortgage on the premises known and described as Lots 10, 11 and 12, in block 1003, "Map of New Tacoma, W. T."

It being expressly understood and agreed that the total par value of all of said second mortgage bonds shall not exceed the sum of \$750,000.00.

The Directors next discussed the advisability of holding meetings of the Board at regular intervals and it was moved, seconded and carried that regular meetings of the Board shall hereafter be held on the second and fourth Wednesday in each month.

There being no further business, the meeting, on motion, adjourned.

CHARLES DRURY,
Chairman.

Attest: M. M. OGDEN,
Secretary.

The court will notice that this meeting was held on February 10, 1920, and that it recites that the \$600,000.00 first mortgage was to be executed for the purpose of "*financing the construction and erection of the building*".

On February 20th the Building Company in conformity to the agreement as expressed in the fore-

going resolution delivered to the Bank the Certificate therein provided for, being Exhibit 184 (Tr. p. 1020 *et seq.*), as follows:

CERTIFICATE AND AGREEMENT.

THIS INDENTURE made this 20th day of February, 1920,

WITNESSETH:

That WHEREAS pursuant to resolution of SCANDINAVIAN-AMERICAN BANK OF TACOMA, adopted at a meeting of the Board of Directors of said SCANDINAVIAN-AMERICAN BANK OF TACOMA on the 10th day of February, 1920, a copy of said resolution being attached hereto and marked Exhibit "A" and by this reference made a part hereof as though set forth in full herein, the SCANDINAVIAN-AMERICAN BUILDING COMPANY agreed to execute to SCANDINAVIAN-AMERICAN BANK OF TACOMA, a certificate to deliver to said SCANDINAVIAN-AMERICAN BANK OF TACOMA, bonds of the par value of \$350,000, bearing interest at 6 per cent per annum, payable semi-annually and secured by a second mortgage upon

Lots 10, 11 and 12, in Block 1003, "Map of New Tacoma, W. T." situated in Pierce County, Washington,

the total issue of said second mortgage bonds not to exceed the sum of \$750,000, and

WHEREAS pursuant to said resolution said SCANDINAVIAN-AMERICAN BANK OF TACOMA has executed and delivered to SCANDINAVIAN-AMERICAN BUILDING COMPANY this day a warranty deed of conveyance to said Lots 11 and 12, described in said resolution.

NOW THEREFORE and for and in consideration of the execution of said deed the undersigned, SCANDINAVIAN-AMERICAN BUILDING COMPANY does hereby agree to execute and deliver to SCANDINAVIAN-AMERICAN BANK OF TACOMA, within a period of four (4) months from the 10th day of February, 1920, mortgage bonds of the face or par value of \$350,000, being a part of a total issue of \$750,000; said bonds to bear interest at 6 per cent per annum, payable semi-annually and to contain a tax free covenant with respect to the income thereon as is provided in said resolution and to be secured by a mortgage upon

Lots 10, 11 and 12 in block 1003, "Map of New Tacoma, W. T." situated in Pierce County, Washington,

and upon the delivery of said bonds this certificate to be returned to the undersigned.

IN WITNESS WHEREOF this certificate is executed by said SCANDINAVIAN-AMERICAN BUILDING COMPANY, by its President and Sec-

retary thereunto duly authorized, this 20th day of February, 1920.

SCANDINAVIAN-AMERICAN BUILD-
ING COMPANY,

By CHARLES DRURY,
President.

By J. V. SHELDON,
Secretary.

And, as we have said, the deed was delivered on February 25th.

The building company then proceeded to make contracts with the various contractors for the erection of the building and the furnishing of the material and labor therefor. With the exception of three or four, these contracts all contained clauses whereby the contractor expressly waived the right given by statute to a lien and agreed not to file a lien. (See Art. XIV pp. 187, 188; Art. XIV p. 389; Art. XIV, p. 316).

These waiver clauses were necessary for the reason that the Metropolitan had particularly specified in its commitment that the contracts with the contractors should contain a clause subordinating their lien rights to the lien of its proposed mortgage. (Ex. 177, pp. 981 and 984).

"When the \$600,000.00 mortgage was arranged for it was understood that would take up the \$70,000.00 Penn Mutual mortgage" (Tr. p. 1045).

On March 10, 1920, the building company gave a mortgage for \$600,000.00 running to the broker,

G. Wallace Simpson (Ex. 180, p. 992). This was done in order that it might be used by him to obtain money for the construction of the building pending its completion, when the \$600,000.00 could be obtained from the Metropolitan. This mortgage upon its face bears irrefutable evidence that it was the intention that it ultimately should be assigned to the Metropolitan, since it contains all the terms specified by the Metropolitan, was prepared by the Metropolitan attorneys and was payable at the office of the Metropolitan. It was the intention to use this mortgage and the balance of the \$750,000 bond issue to finance the construction of the building, and the directors of the bank were given to understand that these second mortgage bonds had been placed and would be sold as soon as they were issued, so that the money would be available and the cash paid rather than the bonds. (Tr. 1018).

In fact, this second mortgage bond issue was never executed, and all of the money used by the building company in the erection of the building was drawn from the coffers of the bank; this amounted in all to more than \$500,000.00 in cash.

On October 7th, 1920, Simpson assigned this mortgage to the bank (Ex. 180¹/₂, Tr. p. 1003), and, in fact, the mortgage was in the possession of the bank before any large advances were made to the building company by the bank — that is, in June of 1920.

On January 15, 1921, the bank failed and passed into the hands of the State Banking Department for liquidation. On January 17th, 1921, the Bank Commissioner of the State appointed Forbes Haskell as Special Deputy Bank Commissioner to assist him in the duty of liquidating and distributing the assets of the bank among its depositors. (Ex. 330, p. 1228). On January 18th this action was begun.

The Penn Mutual or \$70,000.00 mortgage was then unpaid and four months overdue, and Haskell was notified by the insurance company that it would insist on the 12% interest which the mortgage provides is to be paid after it became due, unless it was taken care of at once, and further notified that unless they were paid at once, they would start foreclosure proceedings. (Tr. 5. 1215). On February 23, 1921, Haskell obtained an order from the Superior Court directing him to take an assignment of the mortgage, the court finding that it was for the best interest of the creditors of the bank that it be taken up (Ex. 335, Tr. p. 1217), and he purchased it with funds which came into his hands as Deputy Supervisor, taking an assignment thereof, and paid the sum of \$72,366.35, that being 8% on the mortgage from its due date, and representing a compromise between the 6% called for by the mortgage and the 12% provided for after default.

On March 31, 1921, in conformity with the Administrative Code passed by the Washington Legislature in 1921, the former Bank Commissioner was

retired, the title of the office changed to Supervisor of Banking of the State of Washington, and Haskell was reappointed by the incoming Supervisor, J. P. Duke, as Special Deputy Supervisor, and as such assigned this mortgage to his superior, J. P. Duke.

According to all the books and records of the bank and according to the statement of its officers, except Larson, this \$600,000.00, or Simpson mortgage, which had been assigned to the bank, was held by the bank as collateral security for all the indebtedness to the bank of the building company.

THE \$600.000.00 MORTGAGE.

Prior to the incorporation of the Scandinavian American Building Company it was the intention to form a corporation for the purpose of erecting and operating the proposed building, as is shown by the letters to which we have called attention in discussing the facts with reference to the \$70,000 mortgage. It was intended that the building corporation should buy the equity of the bank in the old building and that the only interest the bank should have in the new building would be a lease of the banking room for a long period of time. (Ex. 199-203).

After the building company was organized and had become authorized to do business under the laws of the State of Washington in 1919, its books of account show that it paid for the cancellation of certain leases in the old building, paid its corporation license fee and Simpson's and other expenses and

paid for the Drury lot on February 9, 1920 (Ex. 350, Tr. p. 1142). It then acquired the title of the bank to its property under the agreement which we have mentioned and set forth (Ex. 184), and began to make its contracts with the contractors and materialmen who are the lien claimants in this action. None of these parties can claim that they thought that they were dealing with the bank, in view of the written contracts with the building company, which they then signed. We believe this is not claimed by any of them. As far as the complainant, McClintic-Marshall, is concerned, it cannot even say that it dealt with the building company, in reliance upon any record title to any property, for as a matter of fact its contract was made before the building company had acquired any title whatsoever to any of the real property. Its contract was dated February 5, 1920 (Tr. p. 40).

When the building corporation was organized, Larson subscribed for 1996 out of its total capital of 2000 shares. The other four shares were subscribed by Williamson, Drury, Lindberg and Lindeberg (Tr. pp. 987-988). These five gentlemen owned only 298 out of 4000 shares of the capital stock of the bank, and, in fact, owned less than 1600 out of 10,000 shares of the capital stock of the bank after the capital was increased in April of 1920 (Tr. p. 1236). So that the stockholders in the building company were by no means identical with the stockholders of the bank. Larson claimed that he sub-

scribed for this stock on behalf of the bank. If he had this secret intention, it was unknown to every other member of the board of directors of the bank, and, so far as this record shows, was unknown to every other stockholder in the bank. In fact, this record is replete with evidence that this was not a fact. The letters to which we have called attention, preliminary to the organization of the corporation, bear irrefutable evidence that it was the intention that "finally the only interest the bank would have in the property would be a lease on the banking room and basement" (Ex. 199); that the building company would "purchase the property from the bank and Drury, construct the building and operate it" (Ex. 203). G. G. Williamson, one of the bank's directors and its attorney, flatly contradicted Larson: "It was absolutely represented at the inception that Mr. Larson was subscribing for all of that stock except one share each for the other directors. Mr. Larson was to get the money for the purchase of that stock, he was subscribing for it in his own name, but I do not suppose anybody—at least I did not think that Mr. Larson was going to furnish \$200,000, but he said he had arranged that." (Tr. 1109). Chilberg, who was then the president of the bank, says: "This stock was to be sold. The original plan was to sell it to anybody that would buy it. I suppose somebody would subscribe it as those things are usually done until it could be placed. (Tr. p. 1137). Lindberg, another director

of the bank, says: "There was not, at any meeting of the trustees which I attended, any authorization to Mr. Larson to subscribe for all of the shares of the building company's capital stock except four, for and on behalf of the Scandinavian American Bank." (Tr. p. 1127). Lamborn, another director, says: "I am not sure I ever knew of it. My consent was never asked for the purchase of this stock." (Tr. p. 1172-73). In fact, everyone else even remotely connected with the bank states that it was the understanding at that time that the arrangements for the financing of the construction of this building had been completed in the East and that Larson represented to them that not one cent of the bank's money was to be used for the construction of the building. Williamson says: "I resigned because it had been absolutely represented to the board of directors that the bank was not going to put a dollar in that building. There had been representations all along made to the board, relied upon by the board, and I do not think there was a man on the board that did not have that belief and firm conviction. The first time it ever came to my knowledge that the bank had advanced a dollar was the time I told you about, and I got out just as quick as I could." (Tr. p. 1118-1119). That Williamson did resign then is shown by his written resignation (Tr. p. 1016). Lindberg: "I heard Larson had the building financed; that was the purpose of forming this

company." (Tr. 1126). "I did not understand then that the bank would have some stock in the building. I did not hear that the bank, after that, would have control of the building." (Tr. 1128). Thompson, also a director of the bank, testified: "I wished to have an assurance by Mr. Larson that the building . . . would be financed . . . independently of the bank, and that none of the bank's funds would be used. That impression was carried in my mind all the time I was a director of the bank, that the financing of the new building would be done outside the bank." (Tr. 1148). Sheldon, another trustee, testified: "I was told by Mr. Larson that a building was to be built, costing seven or eight hundred thousand dollars, that could all be financed outside the bank." (Tr. 1153). Lamborn: "I did not ask him specifically as to the use of the funds of the bank in this building; that was not discussed at all. It was not necessary, because he had said he had financed it and the money was ready in New York." (Tr. 1172). Indeed, Larson, at another place in his testimony, says: "It was never the intention that the Scandinavian American Bank of Tacoma was intended to finance that building. Never was at any stage of the game the intention that the bank should finance any part of it." (Tr. p. 1084).

As far as the credibility of the witness Larson is concerned, he had conceived the idea that the supervisor and his attorneys had been instrumental in having some thirty-odd criminal indictments re-

turned against him, and repeatedly showed his hostility to the supervisor, and repeatedly refused to answer questions propounded by the supervisor's attorneys upon the ground that they would tend to incriminate him (Tr. 1051, 1084, 1085 and 1088), although he had no such fears when asked questions by the other attorneys in the case. So that, notwithstanding Larson's testimony, there is no question but what this stock was subscribed for by him as an individual and for his individual account. This is further borne out by the letters written to Larson by Mr. Hay, who was then the Bank Commissioner of the State of Washington. Under date of June 21, 1920 (Ex. 219, Tr. p. 1086, at 1088), Hay wrote to Larson, forbidding the bank to carry any of the second mortgage bonds and stated as follows:

"As I recall it, you told me at one time in Tacoma that your building was to be financed without using one cent of the bank's funds."

Again, under date of Nov. 12, 1920 (Ex. 221, Tr. p. 1090), he wrote:

"At this time it is my desire that the building be constructed and brought to completion without having the Scandinavian American Bank in any way made a party thereto, and I desire particularly to remind you that you must use great care in order that the bank may not be allowed to appear in any way as a guarantor of any bills or accounts in connection with the construction of the building."

At the time that Larson returned from New York with the letter of the Metropolitan, dated September 17, 1919 (Ex. 193), wherein the Metropolitan had agreed to lend \$650,000.00 when the building was completed, Larson says he thought that they were ready to proceed with the building (Tr. p. 1041). At that time the scheme for the financing of the building was as follows: The stock was to be placed as Larson had represented to Williamson and Chilberg, respectively the attorney and president of the bank; the Scandinavian Bank of Seattle was to carry \$150,000 of second mortgage bonds, if necessary, and the Metropolitan was to lend \$650,000.00. At that time Webber had not made his plans, and the understanding was that the building was to cost not to exceed \$860,000.00 (Tr. p. 1040). These were the circumstances surrounding the incorporation of the building company. Thereafter, the Metropolitan loan committee, after an appraisal of the land, reduced the amount of the loan to \$600,000.00. In order to raise the money pending the construction of the building—the Metropolitan having agreed to lend it only when the building was completed—the consent of the Metropolitan was obtained to an arrangement whereby the Metropolitan would take an assignment of the mortgage, and would permit it to be executed to someone else for the purpose of raising money pending the construction of the building (Ex. 222, Tr. 1093; Ex. 224, Tr. 1097), and under an

agreement, afterwards reduced to writing (Ex. 182, Tr. pp. 1010-1011), whereby Simpson declared that he held it in trust, and that any moneys derived therefrom were to be held by him in trust for the use and benefit of the building company, this mortgage was executed. This is the mortgage in controversy. It runs to G. Wallace Simpson, as mortgagee (Ex. 180, Tr. 882 *et seq.*). It was prepared by the Metropolitan attorneys, who personally investigated the building site on the day it was recorded, to ascertain that no work had been done thereon, and who insisted that it be recorded before any work had been done; it is payable at the office of the Metropolitan in New York. A few days prior to that time the building company had obtained title to the bank's property under the agreement to which we have called attention (Ex. 184). At that time Webber's plans had been completed and it was known that the building would cost slightly in excess of one million dollars (Tr. p. 1047). This was to be raised by the Simpson or Metropolitan mortgage of \$600,000.00, a second mortgage bond issue of \$750,000.00 and the stock. At that time Webber and Simpson had represented that the second mortgage bond issue had been placed and the money therefor would be obtained as soon as it was executed and delivered (Tr. 1018). So that it was contemplated at that time that the \$350,000.00 due to the bank would be paid in cash before the tenth of June (Tr. 1019).

The contractors state that at the time they entered into their contracts it was represented to them that the building company had arranged for this \$400,000.00, and that the Metropolitan mortgage of \$600,000.00 would be available for the completion of the building. They claim that this was such a fraud upon them that they are not bound by the waiver clauses contained in their contracts. This shows conclusively two things: First, that the contractors knew of this \$600,000.00 mortgage at the time they signed their contracts; second, that the building company was relying upon the statement of Simpson and Webber that these bonds had been placed.

The bank advanced the building company \$15,000.00 on its note, on December 8th, 1919 (Tr. p. 1031, Ex. 188). This was doubtless in order that it might take care of the preliminary costs, as shown by the building company's books of account (Ex. 352, Tr. p. 1246). On April 14, 1920, the bank advanced another \$25,000, and on May 21, 1920, another \$25,000. These loans were ratified by the board of directors of the bank (Tr. pp. 1013-1014), and it was then that Williamson resigned from the directorate of the bank.

On June 25, 1920, Larson deposited \$200,000 in the bank to the credit of the building company, using therefor the ordinary deposit slip, to which was attached a notation signed by Larson, ordering that "Account No. 13—stocks and securities"—be

debited, and the notation made, "Payment in full stock subscription, Scandinavian American Building Company." (Ex. 190, Tr. 1034-5). This was the entire bank record of this transaction. This was done in the face of the letter written only four days before, and dated June 21, from the Bank Commissioner, to which we have called attention (Ex. 219, pp. 1086-1088), and without the knowledge of the other directors of the bank. Williamson says: "I did not know a thing in the world about it directly or indirectly" (Tr. 990). Again, at page 1168 *et seq.*, he says: "I will state that I did not have any conversation with Mr. Larson in reference to the issuance of any stock. I did not know until after the 8th of January, 1921, that the Scandinavian American Bank had any stock in the building company, . . . that is the first time I knew the Scandinavian American Bank had anything to do with the building company's stock directly or indirectly. The matter had never been mentioned to me by Mr. Larson or anybody else up to that time." Lindberg says: "I was not present when the stock of the company was purchased by the bank; the first I heard that Mr. Larson had the stock was when I read it in the paper after the bank closed" (Tr. p. 1125). Lamborn says: "I am not sure I ever knew about it. My consent was never asked for the purchase of this stock" (Tr. 1172-3). Sheldon says: "The first time I found that the building had obtained a credit, I wanted to know

where the credit had come from and I proceeded to look it up and that is the entry I found. I mentioned it to Mr. Larson afterwards. As a trustee of the bank I was not at any time consulted in reference to the purchase of this stock of the Scandinavian-American Building Company, and had no knowledge of that transaction prior to the time I discovered it myself a few days after June 25, 1920" (Tr. 1159). Others of the officers of the bank considered this as a loan to the building company with the stock as a pledge. Ogden says: "Under the circumstances as I see them now, that the bank advanced that much money to the building company and naturally was entitled to interest on the investment. The bank record shows that the bank at one time bought the stock and later shows that the bank charged interest on the money it bought the stock with" (Tr. 1033). Sharp says: "I find on the books (of the building company) the stock purchase payment of June 25, recited on the books as a deposit *by O. S. Larson*, account capital stock, \$200,000. That entry would be made from the deposit slip, which the bank would have" (Tr. 1111). On December 31, 1920, Larson over his own signature directed the employees of the bank to charge interest at six per cent on this sum (Ex. 235, Tr. 1120-2). Morse says: "I put that there on Mr. Larson's instructions" (Tr. 1184).

Although Larson's certificate of stock and the certificate running to the bank are dated June 25,

1920, the date upon which Larson passed this credit to the building company, the stock was not in fact issued at that time, but was issued apparently some time after the bank had been examined in December of 1920. In this connection Larson says: "It seems to me there was some discussion in December between Mr. Freeman and Mr. Drury about the fact that the certificate had never been issued to the bank" (Tr. 1044). Lindberg says: "I endorsed a certificate for one share after the bank was closed" (Tr. 1127). Williamson says that at the time he endorsed his certificate of stock it was stated to him "that the bank examiner had examined the bank in December and found that the bank was carrying \$200,000 in stocks and the bonds represented by the building company's stocks. The stock was not there and they issued the stock and got all of it but the one share I had" (Tr. p. 1168). Sheldon says: "The records showed a purchase of this stock and the bank did not have the actual stock until December, 1920, it was not issued, but the books showed as early as June 25, 1920, that the stock had been purchased" (Tr. p. 1162). Again he says: "I mean the certificates of stock were not signed until December, 1920." "It was subscribed for by Larson, but the stock was not issued" (Tr. p. 1165). So that all that the bank's records showed at that time, and until December, was a deposit slip of the building company showing a deposit of \$200,000 to its credit, to which was attached a note by Larson or-

dering account No. 13, Stocks and Securities, charged with this item and the entry made in that account in accordance therewith. The stock itself was not there — it had never been issued. It was therefore unintelligible without an explanation, and in fact the Bank Commissioner wrote Larson for an explanation of it (Ex. 280, Tr. p. 1089) in August, but received no reply.

The \$600,000.00 mortgage, although running to Simpson, as the court will notice, was payable at the office of the Metropolitan Life Insurance Company (Ex. 180, Tr. 992), and the architects of the Metropolitan were paid their fees, analyzed the cement that went into the foundations of the building, received frequent reports as to the progress of the work, and even went so far as to insist upon certain changes being made in the plans. There can be no question, therefore, but that during all this period the Metropolitan itself, and everybody connected with the transaction, considered that the Metropolitan would be the ultimate purchaser of this mortgage, and that it was made to Simpson merely in order that it might be used for the purpose of obtaining loans pending the completion of the building (Ex. 222, Tr. p. 1093 and Ex. 224, Tr. p. 1097 *et seq.*). The declaration signed by Simpson states: "Said note and mortgage having been made to me as a matter of convenience and to enable me to raise funds for the Scandinavian American Building Company for the purpose of enabling it to erect a

building upon the premises described in said mortgage (Ex. 182, Tr. p. 1010). As a matter of fact, however, the mortgage was at all times in the possession of the bank, and on June 28, three days after Larson had made this unauthorized stock loan to the building company, he wrote Sheldon, the secretary of the building company and one of the directors of the bank, to keep the Simpson mortgage and note "in a safe place ready to be delivered when the funds are to be turned over," and on September 24th Sheldon took a receipt from Larson for these papers (Ex. 248, Tr. pp. 1155-56). Sheldon says he delivered the note and mortgage to Larson in June: "He told me he was going to take them East and get an assignment from Simpson to the bank" (Tr. 1157-1167), and Larson thereafter directed the bank clerks to charge interest on the stock loan, saying "enter this voucher up as a real estate loan and hold until advance is secured on the mortgage, then charge same to account of Scandinavian American Building Company" (Ex. 235, p. 1120). Prior to June 11, Larson was attempting to get the Metropolitan to make advances on the strength of this mortgage, and on that date they wrote a letter in which they declined to make such advances, but stated that "with our commitment and our mortgage of record, I should think that you could arrange to finance the matter with your own funds or those obtained from other sources for temporary use" (Ex. 214, Tr. p. 1080). Larson began lending

money to the building company on the strength of the \$600,000.00 mortgage. This is shown by the fact that when the Metropolitan declined to make advances on the strength of this mortgage and suggested that the bank could do so "with our commitment and our mortgage of record," Larson immediately began to make these loans. This letter is dated June 11th; it would not have reached Tacoma until June 17th or 18th, and Larson made the stock loan within a week, June 25th. And during this time, and in fact up until the failure of the bank, there was a constant endeavor to use this mortgage in order to obtain a temporary loan. This is shown by innumerable letters passing during that time (Ex. 185-187, Tr. p. 1026; 182, Tr. p. 1010; 215, 216, 217, Tr. 1082-3; 222, Tr. p. 1093; 224, Tr. p. 1096; 229, Tr. p. 1105; 336, Tr. p. 1218; 342, 343, 344, 345, 346, Tr. pp. 1224 to 1228).

There is some dispute in the evidence with reference to whether or not this assignment of mortgage was taken for the protection of the bank, Larson claiming that he took the assignment from Simpson, not for the protection of the bank, but because Simpson was "not in the very best of health and I did not want to get the mortgage tangled up in his estate" (Tr. p. 1048). He goes on, however, to state, in the same breath, that Simpson went from Philadelphia to Chicago in order to execute this assignment, and his telegrams to Sheldon at that time indicate that Simpson was going from Chicago to Bos-

ton "trying Evans estate, Hancock and Massachusetts Mutual" (Ex. 346, p. 1228), so that it is evident that Mr. Simpson's state of health was not interfering with his business. On the other hand, Sheldon states positively that Larson took the papers as early as June, saying that he was going to take them East to get an assignment for the protection of the bank (Tr. 1161-62), and that this was officially passed upon at a board meeting thereafter (Tr. 1163). In this Sheldon is corroborated by Lamborn, who says that "I think Mr. Drury mentioned at the time that any advances made at the time were absolutely safe and covered by mortgage or bonds, I cannot recall which" (Tr. p. 1172), and by Mr. Hay, who was then Bank Commissioner (Tr. p. 1178).

This assignment by its terms ran to the bank, and thereafter Larson directed Morse, the assistant note-teller, to hold the mortgage, note and assignment as collateral to advances made by the bank to the building company, and in fact this note and mortgage remained in the bank's records with the assignment until the failure, showing on the face of the entries carried in connection therewith that the mortgage and note were held as a real estate loan (Ex. 185, p. 1026; 187, p. 1026; 188, p. 1030).

This assignment was dated October 7, 1920 (Ex. 180½, Tr. p. 1003). At that time all of the contractors who were furnishing labor or material for the erection of the building had received their pay-

ments in accordance with the terms of their contracts, with the exception of the McClintic-Marshall Company, \$45,820.66 being due to that company at that time, but unpaid because of a dispute between the building company and that company relative to the delay of the McClintic-Marshall Company in furnishing the steel in accordance with the terms of the contract, which required the steel to be delivered before May 6, whereas in fact the steel was not delivered until November. There was also a dispute about faulty fabrication of steel delivered, and the contract with that company required the submission of all disputes to a board of arbitrators, which is a valid and binding contractual obligation, both in the State of Washington and in the State of Pennsylvania, the domicile of the McClintic-Marshall Company.

The Washington Banking Code is found in Remington's Compiled Statutes of Washington, 1922, Sec. 3208 *et seq.* The title of the official charged with the administration of this law has been changed by each Legislature; first it was the "Bank Examiner," then the "Bank Commissioner," then the "Supervisor of Banking." The examiner and commissioner were each appointed directly by the Governor, but the Supervisor is an appointee of the Director of Taxation and Examination, who in turn is an appointee of the Governor.

Under these laws, this official passes upon the organization of State banks, grants them in the first

instance the authority to conduct business (Sec. 3229), and all banks must file sworn reports periodically with him (Sec. 3212), and he must examine them at least once a year (Sec. 3214). If he decides that a bank is insolvent, he may take possession immediately without notice (Sec. 3267). He then collects the assets and liquidates the business, and for that purpose may appoint a special deputy, and files a certificate of such appointment with the county clerk, but can sell, compound or compromise bad or doubtful debts and sell real and personal property only with the approval of the court (Sec. 3269). He publishes notice requiring proof of claims to be made to him within ninety days, approves or rejects all claims, and the claimant must begin action upon a rejected claim within three months, otherwise it is barred (Sec. 3270). He fixes all charges and expenses for liquidation subject to the approval of the court (Sec. 3271). He makes and files his inventory and a list of all claims presented to him showing his action thereon, with the county clerk (Sec. 3272), and declares dividends subject to the approval of the court (Sec. 3273). Any interested person may contest his allowance of a claim before the court in a summary manner (Sec. 3274), and his decision upon the facts requiring him to take possession of the bank must be contested by the bank within ten days and is also heard in a summary manner (Sec. 3275). The power to appoint a receiver is taken away from the courts (Sec. 3276).

After all expenses and claims have been paid in full, he turns any property remaining in his hands over to an agent elected by the stockholders, who converts the assets into cash and distributes them (Sec. 3277).

So that the supervisor is in no sense an officer or agent of the court; he is neither appointed by the court, nor is he accountable to the court. Nor is he in any sense an agent or representative of the bank or of the stockholders of the bank. As soon as he has paid the bank's creditors from its assets, his duties are finished, unless then the stockholders make him their agent.

ASSIGNMENT OF ERRORS.

I.

The court erred in holding in the decree that the mortgage referred to in paragraph XXXIV of the decree known as the Penn Mutual Life Insurance Company mortgage executed by J. E. Chilberg and wife to said company and subsequently purchased by John P. Duke, as Supervisor of Banks of the State of Washington, and assigned to him as such state officer, is not a valid mortgage constituting a first lien upon the real property described in their cross-complaint and described in said decree and prior to any and all other claims and liens, for the reason that said mortgage is a valid mortgage constituting a lien upon the premises for a period of several years prior to the erection of any building

thereon upon which lien claims are asserted in this action. Said mortgage has never been paid and now is legally owned by a state official in the process of liquidating the affairs of the insolvent bank.

II.

The court erred in refusing to enter a decree, as prayed for in these appellants' cross-complaint, foreclosing the so-called Penn Mutual Life Insurance Company mortgage as a lien on the premises of the Scandinavian American Building Company prior to any and all other liens and claims.

III.

The court erred in decreeing that the taking of an assignment of the said Penn Mutual Life Insurance Company mortgage by J. P. Duke, as Supervisor of Banks of the State of Washington, operated as a payment of and to discharge said mortgage and that by reason thereof and for want of equity appellants' cross-complaint should be dismissed, for the reason that the said J. P. Duke was not an agent or representative of the bank, but was acting in his official capacity as an officer of the State of Washington in the process of liquidating the affairs of said bank as provided by the laws of said state, and was authorized and directed by the Superior Court of the State of Washington, in and for the County of Pierce, in charge of liquidation of said bank, to purchase said mortgage and take an assignment thereof for the best interests of the creditors of said bank.

IV.

The court erred in holding the lien claims of McClintic-Marshall Company, Tacoma Millworks Supply Company, E. E. Davis & Company, H. C. Greene, Mullins Bros., Crane Company, Far West Clay Company, Savage-Scofield Company, and the other lien claims allowed in said decree, or any of them, prior in right to the Penn Mutual mortgage, for the reason that said mortgage was a valid and binding lien upon the premises for a number of years prior to the initiation of any other lien right or claim.

V.

The court erred in ordering the application of any part of the proceeds of the sale of the premises and property of the Scandinavian American Building Company to the payment of any liens and claims prior to the application thereof to the payment of the principal and interest of the said Penn Mutual Life Insurance Company mortgage to the said J. P. Duke, as Supervisor of Banks.

VI.

The court erred in holding in the decree that the mortgage for \$600,000.00, known as the G. Wallace Simpson mortgage, and referred to in paragraph XXXVI of the decree, executed by the Scandinavian American Building Company to G. Wallace Simpson, and afterwards assigned to the Scandinavian American Bank of Tacoma, is not a valid mortgage,

constituting a lien upon the real property and premises of the building company and prior to any and all other liens and claims, except the so-called Penn Mutual Life Insurance Company mortgage, for the reason that said mortgage was a valid mortgage of record prior to the initiation of any right or claim of lien on the part of any lien claimants in this action.

VII.

The court erred in refusing to enter a decree, as prayed for in appellants' cross-complaint, foreclosing the so-called Simpson mortgage as a lien on the premises of the Scandinavian American Building Company prior to any and all other liens and claims except the so-called Penn Mutual Life Insurance Company mortgage.

VIII.

The court erred in holding the lien claims of McClintic-Marshall Company, Tacoma Millworks Supply Company, E. E. Davis & Company, Far West Clay Company, and Savage-Scofield Company and the other claims and lien claims allowed in said decree, or any of them, prior to the right of the so-called Simpson mortgage, for the reason that said mortgage was a valid and binding lien upon the premises of the Scandinavian American Building Company prior to the initiation of any other lien rights or claims other than the so-called Penn Mutual mortgage, and that all of said lien claimants

had actual knowledge of the existence of said mortgage prior to the time of delivery of any material or the performance of any labor on the premises of the Scandinavian American Building Company.

IX.

The court erred in ordering the application of any part of the proceeds of the sale of the premises and property of the Scandinavian American Building Company to the payment of any liens and claims prior to the application thereof to the payment of the principal and interest of the said Simpson mortgage, except only the so-called Penn Mutual mortgage.

X.

The court erred in refusing to enter a decree, as prayed for in these appellants' second cross-complaint, establishing a lien upon the real property of the Scandinavian American Building Company in the nature of a purchase money mortgage which arose out of an agreement by which the Scandinavian American Building Company agreed to deliver to the Scandinavian American Bank of Tacoma bonds of the par value of \$350,000.00, and secured by a second mortgage on the premises involved in this action, for the reason that the title to said lots and premises was transferred by the bank to the building company without any consideration other than the agreement to deliver the above bond within four months from February 20th, 1920.

XI.

The court erred in holding any lien claims or other claims prior to the so-called purchase money mortgage other than the Penn Mutual mortgage.

No receiver shall be appointed by any court for any bank or trust company nor shall any assignment of any bank or trust company for the benefit of creditors be valid, excepting only that a court otherwise having jurisdiction may in case of imminent necessity appoint a temporary receiver to take possession of and preserve the assets of such corporation. Immediately upon any such appointment, the clerk of such court shall notify the state bank examiner by telegraph and mail of such appointment and the examiner shall forthwith take possession of such bank or trust company, as in case of insolvency, and such temporary receiver shall upon demand of the examiner surrender up to him such possession and all assets which shall have come into the hands of such receiver.—Remington Compiled Statutes of Wash. (1922), Sec. 3276.

Whenever it shall in any manner appear to the State Bank Examiner that any offense or delinquency referred to in the preceding section renders a bank or trust company in an unsound or unsafe condition to continue its business or that its capital or surplus is reduced or impaired below the amount required by its articles of incorporation or by this act, or that it has suspended payment of its obligations or is insolvent, said examiner may notify such

bank or trust company to levy an assessment on its stock or otherwise to make good such impairment or offense or other delinquency within such time and in such manner as he may specify or if he deem necessary he may take possession thereof without notice. (Sec. 60, Ch. 80, L. 17.)—Remington Compiled Statutes of Wash. (1922), Sec. 3267.

Upon taking possession of any bank or trust company, the examiner shall proceed to collect the assets thereof and to preserve, administer and liquidate the business and assets of such corporation. With the approval of the superior court of the county in which such corporation is located, he may sell compound or compromise bad or doubtful debts and upon such terms as the court shall direct sell all real estate and personal property of such corporation. He shall deliver to each purchaser an appropriate deed or other instrument of title.—Remington Compiled Statutes of Wash. (1922), Sec. 3268.

The examiner shall publish once a week for four consecutive weeks in a newspaper which he shall select, a notice requiring all persons having claims against such corporation to make proof thereof at the place therein specified not later than ninety days from the date of the first publication of said notice, which date shall be therein stated. He shall mail similar notices to all persons whose names appear as creditors upon the books of the corporation. He may approve or reject any claim, but shall serve notice of rejection upon the claimant by mail or

personally. An affidavit of service of such notice shall be prima facie evidence thereof. No action shall be brought on any claim after three months from the date of service of notice of rejection.

Claims may be presented after the expiration of the time fixed in the notice, and if approved, shall be entitled to their proportion of prior dividends, if there be funds sufficient therefor, and shall share in the distribution of the remaining assets. (Sec. 63, Ch. 80, L. 17).—Remington Compiled Statutes of Wash. (1922), Sec. 3270.

When all proper claims of depositors and creditors (not including stockholders) have been paid, as well as all expenses of administration and liquidation and proper provision has been made for unclaimed or unpaid deposits and dividends, and assets still remain in his hands, the examiner shall call a meeting of the stockholders of such corporation, giving thirty days' notice thereof, by one publication in a newspaper published in the county where such corporation is located. At such meeting, each share shall entitle the holder thereof to a vote in person or by proxy. A vote by ballot shall be taken to determine whether the examiner shall wind up the affairs of such corporation or the stockholders appoint an agent to do so. The examiner, if so required, shall wind up such corporation and distribute its assets to those entitled thereto. If the appointment of an agent is determined upon, the stockholders shall forthwith select such agent by ballot. Such agent

shall file a bond to the State of Washington in such amount and so conditioned as the examiner shall require. Thereupon the examiner shall transfer to such agent the assets of such corporation then remaining in his hands, and be relieved from further responsibility in reference to such corporation. Such agent shall convert the assets of such corporation into cash and distribute the same to the parties thereunto entitled, subject to the supervision of the court. In case of his death, removal or refusal to act, the stockholders may select a successor with like powers.—Remington Compiled Statutes of Wash. (1922), Sec. 3277.

Argument

The taking of testimony in this case was spread over a period of approximately two months, due to the fact that the court was continuously interrupted by the necessity of trying other cases both in Tacoma and in Seattle. Thereafter the court took the case under advisement and delivered his opinion, which is found in 281 Fed. 166, some six months thereafter, in which he held that the liens of the mechanics and materialmen were superior to the lien of both the mortgages held by the supervisor.

From an examination of the court's decision it will be observed that the facts and circumstances involved in the two mortgages are in many details very closely related, and an examination of the testimony will satisfy the court that they are inter-related even more closely than indicated in the court's opinion. For this reason our argument will

in many respects be applicable to both mortgages, and although we have attempted to present our arguments under various heads, we request the court to keep in mind the statement we have just made. For the purpose of convenience we present our argument under the following heads:

1. VALIDITY OF THE \$70,000.00, FIRST MORTGAGE.

2. VALIDITY OF THE \$600,000.00 MORTGAGE.

3. VALIDITY OF THE PURCHASE MONEY MORTGAGE.

4. EFFECT OF THE ARBITRATION CLAUSE IN THE McCLINTIC-MARSHALL COMPANY CONTRACT.

5. EFFECT OF LIEN WAIVER IN THE CONTRACTS OF LIEN CLAIMANTS.

VALIDITY OF THE \$70,000.00, FIRST MORTGAGE.

The court in its decision, in a rather summary manner and without citation of any authority, denied this mortgage priority over the various lien claimants. We will analyze briefly the decision of the court, but deem it advisable to do so after we have presented our argument to sustain the priority of this mortgage over all other mortgages and liens.

The validity of this mortgage is attacked upon the theory that when the Bank Commissioner of the

State of Washington and his deputy, F. P. Haskill, purchased this mortgage and took an assignment thereof, the mortgage, by reason of said act, was extinguished; that the court will conclusively presume that the Bank Commissioner by said purchase was acting for the bank and with the *intention* of paying the obligation of the mortgage for and on behalf of the bank, and that there was a legal and binding obligation upon the bank to pay said mortgage, and the Bank Commissioner in purchasing said mortgage was merely discharging said obligation. This argument, however, is without merit for the following reasons:

1. The Bank Commissioner was not an agent of the bank but an officer of the State of Washington.

2. There was no intention on the part of the Bank Commissioner to pay the mortgage and extinguish the same; *intention* is the controlling factor in this transaction. This intention is to be gathered either from evidence or the circumstances of the transaction.

3. The Bank Commissioner was under no legal obligation to satisfy this mortgage and pay the debts secured thereby.

4. The bank, acting in its own behalf, could, after the building company breached its contract pursuant to which it obtained title to the lots from the bank, have purchased said \$70,000.00 mortgage if necessary to protect its interests under said contract.

5. The lien claimants could not themselves have compelled the bank to pay off said mortgage except upon the express condition that the equities of the bank would be protected.

6. That the equity of the lien claimants were in no manner altered by the transaction because of the fact that the mortgage was at all times prior to the claims of all lien claimants.

7. The statutes of the State of Washington expressly prohibit the appointment of a receiver to liquidate a state bank.

8. None of the lien claimants testified that they relied upon any warranty of title to the property.

9. At the time the McClintic-Marshall contract was entered into the title of the property was in the bank and was not transferred by the bank to the building company until at a later date.

THE BANK COMMISSIONER WAS NOT AN AGENT OF THE BANK.

We are fully satisfied that the error of the trial court in refusing to sustain the validity of the \$70,000.00 mortgage as a first and prior lien was due to the fact that he utterly failed to distinguish the fundamental difference between the official capacity of the Bank Commissioner as a state official in the liquidation of the affairs of the bank and that of a receiver. In every instance where reference is made to the subject in his decision, he refers to the receiver of the bank and not to the

Bank Commissioner. Constant reference is made to Haskill as receiver for both the bank and the building company. The difference, however, was argued during the trial, and we are unable to explain why he should have ignored this difference and disregarded the decisions of the Supreme Court of the State of Washington where the vitally distinguishing features have been so forcibly pointed out, and this even so very recently; and also the Statutes of the ~~State of Washington~~ ^{United States}, which expressly prohibit the appointment of a receiver to liquidate a state bank, and also the decisions of the Supreme Court of the State of Washington, which expressly follow and state they follow the decisions of the Supreme Court of the United States on that subject.

We cite the following authorities:

Hansen v. Soderberg, 105 Wash. 255, 177 Pac. 827;

Kennedy v. Gibson, 75 U. S. 498;

Gibson v. Peters, 150 U. S. 342, 37 L. Ed. 1104;

Ex parte Chetwood, 165 U. S. 443, 41 L. Ed. 782;

U. S. v. Weitzel, 246 U. S. 540, 62 L. Ed. 872;

Weitzel v. U. S., 274 Fed. 101;

Greenfield Savings Bank v. Commonwealth, 97 N. E. 927;

Commonwealth v. Allen, 133 N. E. 625;

Bryan v. Bullock, 93 So. 182;

Allen v. Prudential Trust Co., 136 N. E. 410;

Cosmopolitan Trust Co. v. Nichol, 136 N. E. 403;

Witter v. Sowels, 32 Fed. 765;

Armstrong v. Ettlesohn, 36 Fed. 209.

We wish to emphasize the fact that the Supreme Court of the State of Washington, in an *en banc* decision concurred in by all judges of that court, expressly adopted and followed the rule laid down by the Supreme Court of the United States in holding that the State Bank Examiner of the State of Washington in liquidating an insolvent state bank was not acting as a receiver of a court but as an officer and agent of the State of Washington. The case referred to is that of *Hansen v. Soderberg*, 105 Wash. 255, 177 Pac. 827, in which the court calls attention to the fact that the state banking laws of Washington are in many respects similar to the provisions of the National Bank Act, and we quote to some extent the language of the decision:

“Without setting out in detail the corresponding provisions of the National Bank Act (U. S. Comp. St. 1916, par. 9821; Rev. Stat. par. 5234), it may be said that the statute of this state bears a striking similarity in many of its provisions to that act of Congress. Under the National Bank Act the comptroller of the currency administers the affairs of an insolvent national bank and determines the liability, if any, of the stockholders without resorting to a judicial inquiry. That act contains the provisions that the comptroller of the currency ‘may, if necessary to pay the debts of such association, enforce the individual liability of the stock-

holders' (U. S. Comp. St. 1916, par. 9821). In effect this language is the same as that contained in the legislative act of this state above quoted.

"The United States Supreme Court, construing the Federal act, has held that the comptroller has power to decide when it is necessary to institute proceedings against the stockholders of an insolvent national bank to enforce their personal liability; that this question is referred to his judgment and discretion, and that his determination thereof is conclusive. In *Kennedy v. Gibson*, 75 U. S. (8 Wall.) 498, upon this question it is said:

" 'The receiver is the instrument of the comptroller. - He is appointed by the comptroller, and the power of appointment carries with it the power of removal. It is for the comptroller to decide when it is necessary to institute proceedings against the stockholders to enforce their personal liability, and whether the whole or a part, and if only a part, how much, shall be collected. These questions are referred to his judgment and discretion, and his determination is conclusive. The stockholders cannot controvert it. It is not to be questioned in the litigation that may ensue. He may make it at such time as he may deem proper, and upon such data as may be satisfactory to him. This action on his part is indispensable whenever the personal liability of the stockholders is sought to be enforced, and must precede the institution of suit by the receiver. The fact must be distinctly averred in all such cases, and if put in issue must be proved.' "

“The National Bank Act provides for the appointment of a receiver by the comptroller, and that the receiver acts under the direction of the comptroller. The view of the court, as expressed in *Kennedy v. Gibson*, *supra*, has been adhered to by that court in *Casey v. Galli*, 94 U. S. 673, and *United States v. Knox*, 102 U. S. 422” . . .

“So far as our inquiry discloses, no court of last resort in any state, when the precise question was directly presented, construing a law of its particular state, has taken the opposite view. This statement is made with full knowledge and after careful reading of all the authorities cited in appellant’s brief.” . . . “A holding that the state bank examiner may determine the difference between the liabilities and the assets of an insolvent bank and the necessity for an assessment of the stock gives the act a construction which renders it speedy, efficient and economical. If the act should be construed that the state bank examiner must resort to a court of equity to have these matters determined before he can bring an action upon the stock, the procedure would be substantially the same as it was prior to the passage of the statute. It is well known that, under that procedure, the administration of insolvent banks was subject to much delay and involved, many times, a large amount of costs and expenses. It is to the interest of the creditors, and also the stockholders, that the affairs of an insolvent banking institution should be wound up

with reasonable expedition and with no more expense than the necessities of the situation may require. A review of the act of 1915 and a comparison of it with the National Banking Act indicate that the legislature must have had the Federal act in mind at the time that the statute was passed, and also the construction which the United States Supreme Court had given the Federal act. We think that the state bank examiner, in proceeding as he did in this case, was acting within the power with which he was clothed by the statute." . . .

"The appellant further contends that if a construction be given the statutes such as above indicated, then it cannot be sustained because it confers upon a ministerial officer judicial power. This question has also been decided against appellant's contention by the United States Supreme Court. *Bushnell v. Leland*, 164 U. S. 684; *In re Chetwood*, 165 U. S. 443. In the case last cited it is said:

" 'It has been so often decided that the authority vested in the comptroller to appoint a receiver of a defaulting or insolvent national bank, or to call for a ratable assessment upon its stockholders, is not open to objection, because vesting that officer with judicial power in violation of the Constitution, that we have recently declined to re-examine that question.' "

"It is possible that, in cases analagous in principle, the decisions of this court could be resorted to as sustaining the proposition that the act does

not confer judicial power upon the state bank examiner in violation of the Constitution. At the risk, however, of having this opinion appear superficial, we will not enter upon a review of these cases, because to do so would extend the opinion, as it seems to us, unnecessarily."

In *Ex parte Chetwood*, 165 U. S. 443, 41 L. Ed. 782, the court in holding that a receiver of a national bank appointed by the comptroller of the currency is not the officer of any court, but the agent and officer of the United States, used the following language:

"The receiver was appointed by the comptroller of the currency, January 4, 1889, and Chetwood commenced his suit July 19, 1890. The receiver was not the officer of any court, but the agent and officer of the United States, as ruled by Mr. Justice Gray, on circuit, in *Price v. Abbott*, 17 Fed. Rep. 506, and by Mr. Justice Jackson, then circuit judge, in *Armstrong v. Trautman*, 36 Fed. Rep. 276. And see *Porter v. Sabin*, 149 U. S. 473 (37, 815, 818); *Platt v. Beach*, 2 Ben. 303; *Frelinghuysen v. Baldwin*, 12 Fed. 395; *Armstrong v. Ethelsohn*, 36 Fed. Rep. 209.

"It has been so often decided that the authority vested in the comptroller to appoint a receiver of a defaulting or insolvent national bank, or to call for a ratable assessment upon its stockholders, is not open to objection because vesting that officer with

judicial power in violation of the Constitution that we have recently declined to re-examine that question. *Bushnell v. Leland*, 164 U. S. 684 (*ante* 244) . . . Our attention has been called to no case in which it has been held that the filing of such petitions by national bank receivers in the Federal courts operates to make the receiver an officer of the court or to place the assets of the bank within the control of the court in the sense in which control is acquired where a receiver is appointed by the court."

In *Gibson v. Peters*, 150 U. S. 342, 37 L. Ed. 1104, the court held that a receiver of a national bank being liquidated under the U. S. banking laws was an officer and agent of the United States.

In *United States v. Weitzel*, 246 U. S. 540, 62 L. Ed. 872, it was held that the receiver of a national bank appointed by the comptroller of currency to take possession of the assets of the bank and assume control of its affairs is not an "agent" of the bank.

In this case the receiver of the national bank appointed by the comptroller of currency was indicted in the District Court of the United States for the Eastern District of Kentucky for embezzlement in making false entries under Revised Statutes, Sec. 5209. "That section does not mention receivers, it provides that every president, director, cashier, teller, or agent of a national bank who commits these offenses shall be punished by imprisonment

for not less than five years nor more than ten years. The government contended that the receiver was an agent within the meaning of this act. A demurrer to the indictment was sustained on the ground that he is not."

Justice Brandeis, in writing the decisions of the court, used the following language:

"The receiver, unlike a president, director, cashier, or teller, is an officer, not of the corporation, but of the United States. *Re Chetwood*, 165 U. S. 443, 458; 41 L. Ed. 782, 787; 17 Sup. Ct. Rep. 385. As such he gives to the United States a bond for the faithful discharge of his duties; pays to the treasurer of the United States moneys collected; and makes to the comptroller reports of his acts and proceedings. Rev. Stat. § 5234. Being an officer of the United States he is represented in court by the United States attorney for the district, subject to the supervision of the solicitor of the treasury. Sec. 380 Comp. Stat. 1916 § 556; *Gibson v. Peters*, 150 U. S. 342, 37 L. Ed. 1104, 14 Sup. Ct. Rep. 134. And because he is such officer, a receiver has been permitted to sue in the Federal court regardless of citizenship or of the amount in controversy. *Price v. Abbott*, 17 Fed. 506. In a sense he acts on behalf of the bank. The appointment of a receiver does not dissolve the corporation (*Chemical Nat. Bank v. Hartford Deposit Co.*, 161 U. S. 17, 40 L. Ed. 595, 597; 16 Sup. Ct. Rep. 439); the assets re-

main its property (*Rosenblatt v. Johnston*, 104 U. S. 462, 26 L. Ed. 832); the receiver deals with the assets and protects them for whom it may concern, including the stockholders; and his own compensation and expenses are a charge upon them (§ 5238, Comp. Stat. 1916 § 9825). But a receiver is appointed only when the condition of the bank or its practices make intervention by the government necessary for the protection of noteholders or other creditors. While the receivership continues the corporation is precluded from (542) dealing by its officers or agents in any way with its assets. And when all creditors are satisfied or amply protected, the receiver may be discharged by returning the bank to the control of its stockholders, or by the appointment of a liquidating agent under Act of June 30, 1876, chap. 156 (19 Stat. at L. 63 Comp. Stat. 1916, § 9826). Whether, as the government assumes, such statutory agent who is elected by the stockholders is included under the term 'agent' as used in § 5209, we have no occasion to determine. The question was expressly left undecided in *Jewett v. United States*, 53 L. R. A. 568, 41 C. C. A. 88, 100 Fed. 832, 840. But the assumption, if correct, would not greatly aid its contention. The law can conceive of an agent appointed by a superior authority, but the term 'agent' is ordinarily used as implying appointment by a principal on whose behalf he acts. The fact that in this section the words

'clerk or agent' follow 'president', director, cashier, or teller' tends under the rule of *noscitur a sociis* to confirm the inference (*United States v. Saben*, 235 U. S. 237, 249; 59 L. Ed. 210, 213; 35 Sup. Ct. Rep. 51). Furthermore the term 'agent' of a 'bank' would ill describe the office of receiver."

"To the same effect are the following cases:

2 C. J. p. 420, § 4; Mechem, Agency, § 1, p. 1; *Todd v. United States*, 158 U. S. 282, 39 L. Ed. 982, 15 Sup. Ct. Rep. 889; *Jewett v. United States*, 53 L. R. A. 568, 41 C. C. A. 88, 100 Fed. 832; *United States v. Hartwell*, 6 Wall. 385, 18 L. Ed. 830; *State v. Hubbard*, 58 Kan. 797, 39 L. R. A. 860, 51 Pac. 290; *Witters v. Sowles*, 32 Fed. 762; High, Receivers, 3d ed., §§ 1 and 360; *Kennedy v. Gibson*, 8 Wall. 505, 19 L. Ed. 478; *Re Chetwood*, 165 U. S. 458, 41 L. Ed. 787, 17 Sup. Ct. Rep. 385; *Texas & P. R. Co. v. Bledsoe*, 2 Tex. Civ. App. 88, 20 S. W. 1135; *Texas & P. R. Co. v. Geiger*, 79 Tex. 13, 14 S. W. 214; *Brown v. Warner*, 78 Tex. 543, 11 L. R. A. 394, 22 Am. St. Rep. 67, 14 S. W. 1032; *Booth v. Clark*, 17 How. 328, 15 L. Ed. 166.

In *Witters v. Sowles, et al.*, 32 Fed. 762, the Circuit Court held that "the bank examiner was not an officer or agent of the bank and had no authority, as such, to act for the bank in any manner, and could not bind it by any act done or undertaken in its behalf."

HASKELL WAS AN OFFICER OF THE STATE OF WASHINGTON.

The Bank Commissioner and his deputy, in liquidating the bank, were not in any sense of the word acting as agents of the bank, but distinctly as officers of the State of Washington and in their official capacity as such. The purpose of the banking act of this state is to secure the liquidation of an insolvent bank through state officials, and the act itself provides that *no receiver shall be appointed for an insolvent bank* except temporarily and for a few days in an emergency. Haskell cannot then be considered a receiver of the bank in view of the fact that the Legislature has seen fit by its express declaration to prohibit any receiver from being appointed for the bank. There is certainly, then, a decided difference between the bank commissioner and a receiver.

The case of *U. S. v. Weitzel*, 246 U. S. 540, as above indicated, held that the receiver of a national bank was not an agent of the bank. Weitzel was thereupon indicted under a Federal statute for embezzlement of the bank's funds as an officer of the United States and convicted. In 274 Fed. 101, the conviction was sustained and it was held that in acting as receiver for the bank Weitzel was an officer of the United States.

In *Weitzel v. U. S.*, 274 Fed. 101, the Circuit Court of Appeals, Sixth Circuit, used the following language:

"Each indictment is criticised as fatally defective, because, as asserted, the receiver of an insolvent national bank, appointed by the comptroller of the currency, is not an officer of the United States and in its employment. We think this objection foreclosed by the decision of the Supreme Court in *United States v. Weitzel*, 246 U. S. 533, 38 Sup. Ct. 381, 62 L. Ed. 872, where, on review of an order dismissing a demurrer to an indictment charging this plaintiff in error, under section 5209 of the Revised Statutes (U. S. Comp. Stat. sec. 9772) with embazzlement and making false entries as an agent of the bank here in question, it was held (affirming the judgment of the District Court), that the receiver, unlike a president, director, cashier or teller, is an officer, not of the corporation, but of the United States. True, it was not necessary to an affirmance of the judgment below that the Supreme Court should affirmatively define the actual legal status of the receiver. It is enough that it unequivocally did so. That this was a considered conclusion is evidenced by the citation of several prior decisions of that court, holding the receiver of a national bank to be an officer of the United States."

In *Greenfield Savings Bank v. Commonwealth*, 97 N. E. 927, the Supreme Judicial Court of Massachusetts said:

"The bank commissioner, under the terms of the statute, took possession of all the 'property and busi-

ness' of the bank. This description includes the franchise, for a franchise is a legal estate and not a mere naked power vested in the corporation. *Society for Savs. v. Coite*, 6 Wall. 594-606, 18 L. Ed. 897. The bank had nothing left in its possession except the fragmentary privileges described in sections 13 and 14 of the act, to apply to the court and to call a meeting of the incorporators, and appoint agents for liquidation. There is left to it none of the franchise rights which were decisive in *Com. v. Barnstable Sav. Bank*, 126 Mass. 526. The bank commissioner took possession of the property and business of the petitioner, not as a receiver appointed by a court, but as a public officer, with many of the powers of a receiver and in most respects subject to the direction of the court to carry out a legislative policy for liquidation established as to savings banks whose depositors' interests are not being properly conserved. This policy does not necessarily contemplate a winding up of the corporate existence of every institution of which the bank commissioner may take possession But in general the policy established by the act is that of final liquidation. In carrying out this legislative policy the bank commissioner does not avail himself of the powers conferred by the act of incorporation, as does the receiver of a public service corporation or a private corporation authorized to continue the business, but acts entirely in pursuance

of the powers created by the statute. The bald existence of the corporation remains, but all its other substantial rights and privileges are in suspension."

In *Commonwealth v. Allen*, 133 N. E. 625, (Mass.) the court defined the status and power of the commissioner of banks as follows:

"The commissioner is an executive or administrative officer. He exercises visitorial powers, is charged with duties of rigid inspection, and, when circumstances exist enumerated in St. 1910, c. 399 par. 2 (G. L. C. 167, par. 22), may take and retain possession of the property and business of the bank for the purpose of liquidation of its affairs in accordance with the statute. He acts in all these particulars as a public officer, and not as a receiver appointed by the court. While he possesses some powers commonly conferred upon a receiver, and in many respects is subject to the direction of the court, he nevertheless carries out directly and in his own official capacity a legislative policy. His chart is the legislative mandate as declared in the statute. *Greenfield Savings Bank v. Commonwealth*, 211 Mass. 207, 209; 97 N. E. 927)."

In *Bryan et al. v. Bullock*, 93 So. 182, the Supreme Court of Florida, in holding that the appointment by the state comptroller of a receiver to take charge of the assets and affairs of a state bank which has forfeited its rights and privileges in the comptroller's discretion, is not the appointment of a

receiver within the meaning of the law that makes the power of appointing a receiver a judicial function, said:

“The appointment of a receiver is a judicial function. But is the appointment by the comptroller of an agent, “receiver”, to take charge of the assets and affairs of a state bank, which has forfeited its rights, privileges, and franchises in the comptroller’s discretion, the appointment in fact of a receiver, within the meaning of the law that makes the power of appointing a receiver a judicial function? If that question is answered in the negative, then the argument of counsel for the plaintiff in error must fail.

“The business of banking is an occupation which bears such an intimate relation to the affairs of man that the proper supervision and control of its affairs and methods of transacting business, the discharge of its functions and obligations, is of great importance, to the end that the peace of the community, the welfare of the people, the orderly functioning of industrial activities, and the preservation of faith, and confidence, in commercial transactions be secured and maintained. A banking company’s relation to the community is so intimate and its service of such far-reaching and comprehensive scope, that it has become a quasi public function, and almost, if not quite, classed as a public utility.”

“The convenience and necessities of the people in their various activities are so dependent upon

sound banking operations and strict observance of sound banking principles that a violation by a banking corporation or association of rules and regulations which are deemed important to the orderly and safe administration of its affairs becomes a baleful influence in the community, tending to impair, if not destroy, the harmony of social and business intercourse. Such improper conduct on the part of a banking company becomes more than the violation of an individual or personal right. If it involved nothing more than the property loss of the officers and stockholders of the corporation, its transgression might be more lightly regarded; but such dereliction of duty involves much more than that. It tends to impair the credit and consequent efficiency in a commercial and industrial way of great numbers of people, who may be patrons and correspondents of the company. It tends to impair the facilities of commercial intercourse, for the time renders the earning of a livelihood more difficult, promotes distrust, and tends to destroy confidence which is so essential in all relations and so necessary to the peace of society."

"In view of these considerations the Legislature, in the exercise of its police power, has prescribed certain rules and regulations with which state banks shall comply as conditions upon which the transactions of such a business shall be carried on, and upon which management and control shall depend."

We call the court's attention to case of *Allen v. Prudential Trust Co.*, 136 N. E. 410, in which the Supreme Court of Massachusetts, in holding that a commissioner of banks in liquidating an insolvent trust company, is not acting as a receiver, but is carrying out a legislative policy, reviews in considerable detail the decisions of many of the states of the Union and of the Federal Court and points out the fact that these various courts have adopted the rule laid down by the Supreme Court of the United States.

In *Cosmopolitan Trust Co. v. Mitchell*, 136 N. E. 403 (Mass.), the court in holding that "the commissioner of banks, not being a receiver, but an executive or administrative officer, carrying out a legislative policy, was not required to secure permission of the court to bring the suit" and that said officer is not a receiver, and upholding the constitutionality of the Massachusetts banking act in reference thereto, based its decision in part upon the following language:

"The business of banking vitally concerns the public interests. Long established usage has given its sanction to legislative supervision and regulation to a greater or less extent of the conduct of banks. The prevention and redress of the evil and damage to individuals and to the public likely to arise from violation of their charters and of general laws and from insolvency of banks, have received the attention of the General Court at least since the enact-

ment of St. 1838 c. 14. It is of vast importance to the commercial prosperity, the manufacturing activity and the industrial welfare of the community that banks be managed with integrity and sagacity and according to the rules of law prescribed for their administration. The savings of the poor, the earnings of the thrifty and the resources of the wealthy alike depend upon the prevention of delinquency on the part of those who control and direct the affairs of banks. Checks drawn against deposits in banks have come to replace to so great an extent the use of currency and coin in the ordinary transactions of life that whatever rationally conserves their security is in the common interest. Reason and authority agree that the police power rightly may be exerted within rational limits to regulate and protect the safety of banking. *Commonwealth v. Farmers and Mechanics' Bank*, 21 Pick. 542, 32 Am. Dec. 290; *Noble State Bank v. Haskell*, 219 U. S. 104, 31 Sup. Ct. 186, 55 L. Ed. 112, 32 L. R. A. (N. S.) 1062; *Id.*, 219 U. S. 575, 31 Sup. Ct. 209, 55 L. Ed. 341."

THERE WAS NO INTENTION OF THE BANK
COMMISSIONER TO PAY THE MORTGAGE
AND DISCHARGE THE LIEN THEREOF.

It is decidedly contrary to the testimony in this case to hold that it was the intention of the bank commissioner or his deputy to pay this mortgage and discharge the indebtedness secured thereby. If

he intended to do so, why did he take an assignment thereof? The question of intention in such a transaction is controlling, and such intention may not only be established by the evidence, but may be collected from the circumstances of the transaction, and when these furnish no evidence of intent from the interests of the parties.

It was, however, argued that a court of equity would presume such an intention, and the reasons assigned were based upon the equitable doctrine of merger. We are unwilling to concede that the doctrine of merger has any application to the facts in issue, but will nevertheless discuss the case from that point of view. We believe it will be conceded that the doctrine of merger was intended by equity to work justice, and equity will not declare a merger where such is contrary to the intentions of the parties, or where injustice would result therefrom. It is also essential that the legal and equitable title should unite in the same person in the same right. Therefore, before the doctrine of merger can have any application to this cause it must be legally determined that the bank commissioner is the representative of the bank, rather than a state officer. We submit, however, that the statutes of the State of Washington, the cases cited and the arguments based thereon will satisfy the court that such a determination can not be arrived at.

We call the court's attention to the following authorities on the question of intention being the controlling factor in this transaction:

- 21 Corpus Juris, 1034-5;
 11 Corpus Juris, 689;
 10 R. C. L., 666-7;
Factors and Traders' Ins. Co. v. Murphy et al., 111 U. S. 738, 28 L. Ed. 582;
U. S. v. Stowell et al., 133 U. S. 1, 33 L. Ed. 555;
Beecher v. Thompson, 20 Wash. Dec. 324, 207 Pac. 1056;
Connecticut Inv. Co. v. Demick, 105 Wash. 265, 177 Pac. 676;
Hitchcock v. Nixon, 16 Wash. 281, 47 Pac. 412;
Stuart v. Eaton, 20 Wash. 378, 55 Pac. 314;
Chase National Bank v. Hastings, 20 Wash. 433, 55 Pac. 574;
Nommeson v. Angle, 17 Wash. 394, 49 Pac. 484;
Fitch v. Applegate, 24 Wash. 25, 64 Pac. 147;
Chase National Bank v. Security Sav. Bank, 28 Wash. 150, 68 Pac. 494;
Woodhurst v. Cramer, 29 Wash. 40, 69 Pac. 501;
Bunmer v. Pruitt, 73 Wash. 569, 132 Pac. 237;
McCreary v. Coggeshall, 74 S. Car. 42, 7 A. & E. Ann. Cas. 692 and extensive note.
Pugh v. Sample, 49 So. 526, 39 L. R. A. (N. S.) 834 and note;
Gainey v. Anderson, 68 S. E. 888, 31 L. R. A. (N. S.) 323 and note.
Heath v. Wheeler, 34 N. E. 174;

Boos v. Morgan, 30 N. E. 141;

Bolles v. Beach, 53 Am. Dec. 263.

In 21 C. J. 134, the rule is laid down as follows:

“In equity, the rules of law as to merger are not followed, and the doctrine of merger is not favored. Equity will prevent or permit a merger as will best subserve the purpose of justice and the actual and just intent of the parties, whether expressed or implied. The doctrine of merger has its foundation in the convenience of the parties interested, and therefore whenever the rights of strangers, not parties to the act, that would otherwise work in extinguishment of the particular estate, require it, the two estates will still be considered as having a separate continuance. Whenever a merger would operate inequitably it will be prevented.

“The controlling consideration is the intention, expressed or implied, of the person in whom the estates unit, provided the intention is just and fair, and a merger will not be permitted contrary to such intent. Where there is no expression of intention it will be sought for in all the circumstances of the transaction, and may be gathered not only from the acts and declarations of the owner of the several and independent rights, but from a view of the situation as affecting his interests, at least prior to the presence of some right in a third person. And equity will presume such an intent as is consistent with the best interests of the parties; and the same

presumption is indulged where the party is an infant, or person of unsound mind. The intent of the party does not become fixed and unchangeable until some one acquires an interest in the property, and thereby a right to draw such intent in question."

"The intention that the mortgage lien shall be extinguished will not be presumed where the interest of the purchaser of the mortgage and the mortgaged property requires that the mortgage shall remain in force, as where the result of merger would be to give priority to intervening liens."

11 C. J. 689;

Waterloo First Nat'l Bank v. Elmore, 3 N. W. 547;

Christy v. Scott, 31 Mo. A. 331-6.

In *Factors and Traders' Ins. Co. v. Murphy*, *supra*, the Supreme Court of the United States held that merger would not be permitted in the absence of the intention of the parties, or if, in the absence of any intention, such merger was against his manifest interest, using the following language:

"It was not, therefore, intended to extinguish their liens by this proceeding, but to keep them alive until the property should finally be sold and the money divided. So it is equally clear that it was not for the interest of these lien holders, who were actually purchasing, to extinguish their liens and thereby make Mrs. Murphy's notes a first lien, and enable her to get all her money at their expense.

“The rule on this subject is thus stated by Jones on Mortgages, sec. 848: ‘It is a general rule that when the legal title becomes united with the equitable, so that the owner has the whole title, the mortgage is merged by the unity of possession. But if the owner has an interest in keeping these titles distinct, or if there be an intervening right between the mortgage and the equity, there is no merger.’ And in the case of *Forbs v. Moffatt*, 18 Ves. 384, Sir William Grant says: ‘The question is always upon the intentions, actual or presumed, of the person in whom the interests are united.’ Other authorities cited by Mr. Jones sustain the principle. *Clark v. Clark*, 56 N. H. 105, is directly in point. *Loud v. Lane*, 8 Met. 517; *Armstrong v. McAlpin*, 18 Ohio St. 184.”

We quote at considerable length from the case of *Beecher v. Thompson*, *supra*, for the reason that the opinion is not yet printed in the bound volumes of the Supreme Court decisions of the State of Washington:

“This brings up the question as to whether there has been a merger of the legal title and the interest of the mortgagee, so that the respondent is entitled to the foreclosure of his lien. The chattel mortgage given before the furnishing of labor and material upon the chattel is superior to the lien for such labor and materials. *Rothweiler v. Winton Motor Car Co.*, 92 Wash 215, 158 Pac. 737. Therefore the appellants’ mortgage gave them a right

superior to the respondent's lien. The question is whether the subsequent acquiring of title by assignment of the legal title resulted in a merger which could give preference to the respondent's lien over the appellants' title. The general rule is that the passing of the interest of both mortgagor and mortgagee into the same person does not result in a discharge of the mortgage on the theory of a merger, unless it was so intended by the parties. As stated in 11 C. J. 689:

"The assignment of the interests of both mortgagor and mortgagee to the same person will not operate to discharge the mortgage on the doctrine of merger, unless the parties so intend it. A fortiori after the mortgagee has parted with his interest, an assignment of the equity of redemption to him does not extinguish the mortgage. The intention that the mortgage lien shall be extinguished will not be presumed where the interest of the purchaser of the mortgage and the mortgaged property requires that the mortgage shall remain in force, as where the result of merger would be to give priority to intervening liens, and a transfer of the mortgaged property to the holder of the mortgage, expressly subject to the mortgage debt, evidences an intention that no merger shall be effected."

"This court has followed that rule in several decisions: *Hitchcock v. Nixon*, 16 Wash. 281, 47 Pac. 412; *Nommenson v. Angle*, 17 Wash. 394, 49 Pac. 484; *Stewart v. Eaton*, 20 Wash. 378, 55 Pac. 314;

Chase Nat. Bank of N. Y. v. Hastings, 20 Wash. 433, 55 Pac. 574; *Fitch v. Applegate*, 24 Wash. 25, 64 Pac. 147; *Summy v. Ramsey*, 53 Wash. 93, 101 Pac. 506; *Connecticut Investment Co. v. Demick*, 105 Wash. 265, 177 Pac. 676.

“ The rule is stated as follows in the note to 39 L. R. A. (N. S.) 834 (*Pugh v. Sample*, 123 La. 791, 49 South 526) :

“ . . . the lesser estate in land will merge in the greater whenever the two estate are owned by the same person. This rule, however, does not apply where such merger would be inimical to the interests of the owner, hence, unless an intention to merge with knowledge of a junior lien or liens clearly appears, no merger results from the acquirement by the holder of the senior mortgage of the interests of the mortgagor, and the senior mortgage retains its priority as against all junior or intervening liens upon the mortgaged property;”

“ There is nothing in this case to indicate any intention to merge the legal title and the interest of the mortgagee so that the priority which the appellants held over the respondent's lien would be lost. Equity will not hold transactions such as is revealed by the findings of fact here to be a merger when the natural conclusion from those facts must be, without any other evidence of the intention of the parties, that the mortgagee did not intend to have a merger result, it being more beneficial to him to maintain his interest under his prior mort-

gage, and there being no intention manifested to make the intervening lien superior to his prior rights or accept and pay such lien. As was said in *McCreary v. Coggeshall*, 74 S. C. 42, 53 S. E. 978, 7 L. R. A. (N. S.) 433:

"The view generally held is that merger is not favored in the courts of law or equity; and in equity at least it will not take place if opposed to the intention of the parties either actually proved or implied from the fact that merger would be against the interest of the party in whom the several estates or interests have united. This doctrine is sustained by an unbroken current of authority in the other states of the Union and in England."

"There is nothing in the circumstances surrounding this case which show other than an intention on the part of the appellants to hold their rights under the mortgage. Mere silence is not sufficient, the presumption being against the merger where it is to the interest of the mortgagee that there should not be one, the taking of the legal title not being sufficient of itself to overcome that presumption."

"We do not think that under the almost universal authority this proposition can be questioned. It was evidently to Nixon's interest that there should not be a merger; and that being true, a court of equity would not compel the merger."

Hitchcock v. Nixon, 16 Wash. 281, at p. 286.

"The general rule that a merger will be decreed or not, according to the intention of the parties at

the time of the transaction, and, it must be presumed that it is not the intention of the owner in equity to lose that right because the legal fee passes to him, we must conclude that in this case there is nothing to indicate the intention of Stubblefield to allow his equitable title to be merged in the legal title."

Stewart v. Eaton, 20 Wash. 378 at p. 382.

"We think the rule is quite well settled that, wherever it is more beneficial to the person taking the fee that the mortgage upon it should stand, that circumstance should control in determining the question of intention, and equity will give effect to it by preventing merger and treating the mortgage as a subsisting charge."

Chase National Bank v. Hastings, 20 Wash. 433 at p. 436.

"Where a first mortgagee has released his mortgage of record, surrendered his note to the mortgagor and taken a deed to the property, under the mistaken belief that there were no other encumbrances on the premises, while in fact there was a second mortgage thereon, the first mortgagee is entitled as against the debtor and the second mortgagee, or the assignee of the latter with notice, to be restored to his original rights and lien on the premises by a court of equity."

(Syllabus) *Nomienson v. Angle*, 17 Wash. 394.

“The law is well settled that there is no merger of the mortgage, when the mortgagor conveys to the mortgagee, as against subsequent incumbrances (lien claimants), where it would be inequitable, or where the intention of the parties was otherwise.”

Fitch v. Applegate, 24 Wash. 25 at p. 34.

“A merger of the legal and equitable title does not follow from the conveyance of mortgaged premises to the mortgagee, either where there are outstanding intervening interests or when it is the intention of the parties that no merger shall be accomplished by the transfer.”

Chase National Bank v. Security Sav. Bank,
28 Wash. 150.

“Where a conveyance of mortgaged premises was made to the mortgagee in satisfaction of the mortgage debt, who took same in ignorance of a subsequent judgment lien thereon, and cancelled the mortgage of record, equity will not treat the conveyance as a merger of the mortgage lien in the absolute estate, but will revive such lien as against a purchaser on execution sale.”

Woodhurst v. Cramer, 29 Wash. 40.

We cite the case of *McCreary v. Coggeshall*, *supra*, as reported in 7 A. & E. Ann. Cas. 693, which contains an elaborate discussion of the rule that is quoted by the Supreme Court of Washington in *Beecher v. Thompson*, *supra*: “Merger is not favored in the courts of law or equity and, in equity at least,

will not take place if opposed to the intentions of the parties, either actually proven or implied, from the fact that merger would be against the interest of the party in whom the several estates or interests have united. This doctrine is sustained by an unbroken current of authority in other states of the Union and England." The case is accompanied by an extensive note upon this subject.

An extensive case note upon this same subject is found in *Pugh v. Sample, supra*, 39 L. R. A. (NS) 834.

We again call the court's attention to the fact that the bank was under no obligation to pay this mortgage, and the rule is that "when no such controlling obligation or duty exists, such an assignment shall be held to constitute an extinguishment or an assignment, according to the intent of the parties, and their respective interests, and that subject will have a strong bearing upon the question of such intent."

Strong v. Converse, 85 Am. Dec. 732;
3 Devlin Real Estate, Sec. 1345.

THE BANK COMMISSIONER WAS UNDER NO
LEGAL OBLIGATIONS TO SATISFY THIS
MORTGAGE AND PAY THE DEBT, AND HE
COULD NOT LEGALLY DO SO.

The bank commissioner was under no obligations to pay this mortgage and it was not an enforceable obligation against the bank. The evidence is con-

clusive to the effect that the deed given by the bank to the building company was given without any consideration, in view of the fact that the building company failed to live up to the terms of the contract pursuant to which title was passed by the bank to it. Further, there was an instrument of record introduced as an exhibit in this case, wherein it was agreed that the bank could not be held for the mortgage debt, but only the premises were security for the debt. This mortgage became due in September, 1920, several months after the deed was passed to the building company. No claim was presented to the commissioner for payment of this debt as required by the banking laws of this state, and every claim based thereon was barred by the statute. If an action had been commenced to foreclose this mortgage no money judgment could be recovered against the bank.

The bank commissioner was under the positive duty of administering the funds of the bank for the benefit of all creditors of the bank, and was without right or authority to pay off this mortgage, which would result to the benefit of the creditors of the building company and to the detriment of the creditors of the bank. He was not appointed for the purpose of acting for the building company, but for the purpose of liquidating the affairs of the bank.

A court of equity cannot then presume, notwithstanding the intention of the bank commissioner,

that he was discharging the obligation for the benefit of the creditors of the building company, and to the detriment of the creditors of the bank. A court of equity will not permit such an act, and subsequent lien claimants can not question the validity of the mortgage in the hands of the bank commissioner.

American Trust etc. Bank v. McGettigan, 52 N. E. 793;

Wimpfheimer v. Perrine, 50 Atl. 356;

Lawson v. Warren, 124 Pac. 46;

Cronenwett v. Boston & A. Transp. Co., 95 Fed. 52;

Adams v. Collier, 122 U. S. 382, 30 L. Ed. 1207;

Warren v. Moody, 122 U. S. 132, 30 L. Ed. 1108;

Hauselt v. Harrison, 105 U. S. 401, 26 L. Ed. 1075;

Yeatman v. Savings Institution, 95 U. S. 764;

Marion Trust Co. v. Blish, 85 N. E. 344.

Let us concede, for argument only, that the bank, under the covenants of the deed, was obliged to pay this \$70,000 mortgage, had it remained solvent, despite the record release from personal liability, in so far as the rights of intervening innocent third parties are concerned, yet, upon its insolvency, its liability would only extend to the deficiency judgment upon foreclosure, and as to that liability it

would be the same as to other general creditors. This being the case it would not have been the intent of the Bank Supervisor, in taking this assignment, acting as an agent or officer of the State of Washington and, as such, having charge of the funds of the bank, to pay off this mortgage and thereby give a preference. Had he so intended, the law would not uphold him, and both in law and in equity he would be held to hold such mortgage in his official capacity for the benefit of the trust fund, or equably for all creditors. All the essential elements upon which a merger or extinguishment of the mortgage debt could be predicated are, in this assignment, wholly lacking. The doctrine that whatever transposition of the trust fund may be made by the trustee, the resultant estate vests in the *cestui que trustant* is too elementary to require citation.

The Bank Supervisor, being under no obligation, legal or equitable, to discharge this mortgage debt, his act in using the trust funds for that purpose simply transported the moneys of the funds into the security created by the mortgage and, as such, by means of the assignment, the mortgage became a part of that fund.

In the case at bar the trust fund was used to purchase a note and mortgage and, if not designedly for the interest of all the creditors, it would be a travesty upon the trust fund doctrine to allow it to result otherwise. That a receiver, by design or

otherwise, in dealing with trust funds, might so manipulate them as to redound in greater benefit to one class of creditors as against another, would do such violence to the doctrine that we fail to see how such a proposition can be entertained.

Wimpfheimer v. Perrine, 50 Atl. 356;

Am. Trust & Sav. Bank v. McGettigan, 52 N. E. 793 (Ind.).

The purchase of these notes and mortgage with the creditors' funds, while it may not have been warranted in the exercise of extreme prudence, yet by no precedent can it be held otherwise than in the equal interest of all the creditors, as if a like note and mortgage, a strange instrument to the parties, had been so purchased by the Supervisor.

The rule that when a receiver or trustee purchases property with trust funds, taking the same in his own name and not as receiver, he is held to hold the same in trust for the benefit of those entitled to share in the trust fund, is too well established to require citation. It simply creates a resulting trust.

But counsel for the lien claimants argues, and the court held, that when the bank conveyed title to its property to the building company by warranty deed, the bank thereby became legally obligated to pay the Penn Mutual mortgage, that being an outstanding lien against the title at that time and a breach of the warranty. While we do not agree

with this proposition, if we should assume that this is all correct, and that it was a legal obligation of the bank's for which a claim could have been presented to the Supervisor, this obligation was to the building company, and the Supervisor would have neither the right nor the authority to pay this debt in full to the prejudice of the other creditors of the bank. There is no pretense that this was paid as a dividend, or that there was any intention to extinguish the lien of the mortgage, and the very fact that an assignment of the mortgage was taken rather than a release of it evidences this intention. If this contention is correct in law, then a court of equity would of necessity, in order to prevent an unlawful preference, have to hold that the Supervisor, as representing *all* of the creditors of the bank — the building company included — would have the right to foreclose this mortgage for the benefit of all of the creditors of the bank, and became subrogated to the rights of the Penn Mutual for the benefit of all of the creditors of the bank, the building company included, and that the remedy of the lien claimants would be through the building company as a creditor of the bank.

Tardy's Smith on Receivers, Sec. 110.

"A receiver must act impartially for the best interest of all creditors and he cannot take a course, as, for instance, suing to have a mortgage cancelled that will inure to the benefit of some and to the detriment of others."

Smith on Receivers, Sec. 110.

In *American Trust and Savings Bank v. McGettigan*, *supra*, the court held that a receiver cannot sue to cancel a mortgage given by a corporation where by so doing part of the creditors would be benefited and part of the creditors injured. "A receiver while acting for a court of conscience must act impartially and may not sequester the security of one creditor for the benefit of others who have no equity. The only persons, if any, injured by the alleged fraud were the subsequent creditors without notice, and the receiver cannot maintain an action that shows upon the face of it that the relief sought will place the creditors having an equity in a worse condition, and the creditors having no equity in a better condition, than they occupied before his appointment."

The Supervisor of Banking was under no obligation to pay this mortgage; it was not the obligation of the bank, there was an express written agreement to the effect that the bank should not be liable upon the debt. Prior to the failure of the bank the building company was never in a position to claim damages by reason of the breach of any warranty in the deed from the bank to the building company, because of the fact that the building company was itself in default, it never having delivered the second mortgage bonds which it had agreed to deliver in payment for the property, and subsequent to the failure the building company was not in position to claim any of the assets in the hands of the Super-

visor of Banking by reason of any such breach. The undisputed evidence is that the building company was largely indebted to the bank at all times. The lien claimants in this case stand in the shoes of the building company and can have no greater rights or equities than the building company had.

THE BANK, ACTING IN ITS OWN BEHALF, AFTER THE BUILDING COMPANY HAD BREACHED ITS CONTRACT, PURSUANT TO WHICH IT OBTAINED TITLE TO THE LOTS, COULD HAVE PURCHASED SAID \$70,000.00 MORTGAGE IF NECESSARY TO PROTECT ITS INTEREST IN SAID LOTS UNDER THE CONTRACT.

The bank commissioner was not acting as an agent of the bank in purchasing the mortgage, but was merely acting so as to protect the bank's equity in the lots deeded to the building company, and for which it had received no payment.

And the bank itself was not expected to pay this mortgage, which was to be paid by the building company out of the \$600,000.00. Mr. Larson testified to that effect at page 544 of the transcript of testimony:

“Q. Mr. Larson, when the \$600,000.00 was arranged for, was it your intention so everybody understood, that it would take up the \$70,000.00 Penn Mutual mortgage?

“A. Oh, yes.”

We have heretofore called the court's attention to the fact that the building company had defaulted in its contract. The bank had permitted a six-story building to be torn down from the lots in question upon the express condition that a \$600,000.00 mortgage should be placed upon said premises by the building company, and that it be given \$350,000.00 worth of bonds by June, 1920, secured by a second mortgage on said premises. After the four months' period had lapsed during which this was to have been accomplished, the bank had a clear right to protect its equity in this property and if necessary to purchase the \$70,000.00 mortgage, which did not become due and payable until September, 1920, to protect its equity in the premises.

No citation of authorities is necessary to sustain this statement. We are, however, contending that the bank commissioner was not acting as an agent for the bank in this transaction, and that this mortgage is a valid and enforceable mortgage in the hands of the Supervisor of Banking, for he does not stand in the shoes of the bank, nor does he represent either the bank or its stockholders. In this respect the supervisor differs materially from a receiver, he is not appointed by the court.

THE LIEN CLAIMANTS COULD NOT THEMSELVES HAVE COMPELLED THE BANK TO PAY OFF SAID MORTGAGE EXCEPT UPON THE EXPRESS CONDITIONS THAT THE EQUITIES OF THE BANK WOULD BE PROTECTED.

The contractors, laborers and materialmen were all inferior to the lien of this mortgage as long as it was in the hands of the insurance company, and it was in its hands until after the time when they had a legal right of lien against the premises, and even after this action had been instituted. The bank's equities under and by virtue of the purchase contract of the lots in controversy by the building company could have been successfully asserted against any demand of the building company or its lien claimants. The lien claimants would have been permitted to compel the bank to satisfy the mortgage, only upon the express condition that the bank's equity in the lots be preserved. They can assert no greater interest than the building company could assert, and they can demand or occupy no better position with reference to this mortgage than could the building company acting in its own behalf.

Adams v. Collier, 122 U. S. 382;

Warren v. Moody, 122 U. S. 132.

IF THE BANK ITSELF HAD PAID THIS \$70,000.00 MORTGAGE IT WOULD HAVE BEEN SUBROGATED TO ALL RIGHTS UNDER SAID MORTGAGE, AND IF NECESSARY FORECLOSE SAID MORTGAGE FOR ITS PROTECTION.

We have heretofore set forth the facts with reference to the contract existing between the bank and the building company, and have pointed out, and will hereafter point out, the reasons why the bank, upon the breach of the contract by the building company, was entitled to protect itself under the \$70,000.00 mortgage as well as under the \$600,000.00 mortgage. We cite the following authorities to sustain our contention:

- 2 Jones on Mortgages, Sec. 768, p. 214;
- North End Savings Bank v. Snow et al.*, 83 N. E. 1099 (Mass.);
- Pratt v. Buckley*, 55 N. E. 889;
- Gerdine v. Menage*, 43 N. W. 91 (Minn.);
- Bowles v. Beach*, 53 Am. Dec. 263;
- In re May*, 67 Atl. 120 (Penn.);
- Divine v. Mortgage Co.*, 48 S. W. 585;
- Furmas v. Durgin*, 119 Mass. 500, 20 Am. Rep. 241;
- Williams v. Moody*, 22 S. E. 30 (Ga.);
- Haas v. Dudley*, 48 Pac. 168 (Ore.);
- Strohauer v. Voltz*, 4 N. W. 161 (Mich.).

2 Jones on Mortgages, Sec. 768, lays down the rule as follows:

“If a purchaser who has assumed a mortgage debt omits to pay it when due, the grantor may take an assignment of the mortgage to himself, foreclose the same, and sue for the deficiency, or sue on the agreement, and recover the amount paid by him in obtaining the mortgage, not exceeding the amount unpaid on such mortgage.” Also, “and so a mortgagor, who has sold subject to the mortgage debt, upon being compelled to pay it, is subrogated to the benefit of the security, without any formal assignment of it to him. He thereby becomes an equitable assignee of it and may enforce it against the property.” Citing among other cases,

Risk v. Hoffman, 69 Ind. 137;

Kinnear v. Lowell, 34 Maine 299;

Gerdine v. Menage, 41 Minn. 472, 43 N. W. 91.

In *North End Savings Bank v. Snow*, 83 N. E. 1099, the Supreme Court of Massachusetts held that if a mortgagor conveys his equity in mortgaged property to one who assumes the mortgage and that person fails to pay the mortgage, the mortgagor by paying said mortgage does not by so doing discharge and extinguish the debt and mortgage unless so intended, citing cases to support their decision. ;

In *Pratt v. Buckley*, 55 N. E. 889, the same court held that “The owner of mortgaged lands, selling subject to the mortgage, . . . may take an assignment of the mortgage, and foreclose to

protect herself, and such assignment does not operate as a discharge of mortgage."

In *Gerdine v. Menage*, 43 N. W. 91, the Supreme Court of Minnesota held that after the mortgagor has deeded land incumbranced by the mortgage, which was to be paid by the grantee, if said mortgage is not paid the mortgagor has the same right as any third person to purchase and take an assignment of the mortgage and would be entitled to be subrogated to his right with respect to the land.

In *Bowles v. Beach*, 53 Am. Dec. 263, it was held that the grantor was not estopped by covenants against incumbrances from showing that the deed was really passed subject to incumbrances by verbal agreement, as part of the consideration for passing the deed; and that if the grantee fails to pay the mortgage he has agreed to pay as part of the consideration for the deed, and the mortgagor discharges the mortgage, he is damnified to the extent of the failure by the grantee to discharge the mortgage.

THE EQUITIES OF THE LIEN CLAIMANTS WERE IN NO MANNER ALTERED BY THE TRANSACTION BECAUSE THE MORTGAGE WAS AT ALL TIMES PRIOR TO SAID LIENS.

The argument under this sub-heading has been referred to heretofore. This was a valid and binding mortgage upon the premises at the time the lien

claimants acquired a lien upon the property covered by said mortgage. The fact that a different party purchased said mortgage after the institution of this suit, in no wise prejudiced the lien claimants, but they were left in exactly the same condition they were in when it was held by the Penn Mutual Insurance Company; and by continuing the mortgage in full force and effect the lien claimants were not placed in a worse position than occupied by them when the mortgage was held by the insurance company.

Bormann v. Hatfield, 96 Wash. 270 at p. 274;
Griffin v. International Trust Co., 161 Fed. 48;
In Re Silver, 208 Fed. 797.

In *Bormann v. Hatfield et al.*, 96 Wash. 270, the court held that where a first mortgage is released and a new one taken as a substitute, upon the false representations of the mortgagor that there are no intervening liens, and in ignorance of a second mortgage duly recorded, equity will, in the absence of laches, restore the lien of the first mortgage and give it priority where the holder of a second mortgage is not thereby prejudiced, saying:

“We are of the opinion that the rule, supported both by reason and by authority, is to the effect that, when the holder of a first mortgage takes a new mortgage as a substitute therefor and releases the original mortgage, in ignorance of an intervening lien upon the mortgaged premises, and especial-

ly if the release is induced by fraud or misrepresentation on the part of the mortgagor, equity will, in the absence of laches or other disqualifying fact, restore and reinstate the lien of the first mortgage and give it its original priority. The rule is, of course, subject to the limitation or qualification that by restoring the discharged lien the holder of the junior incumbrance must not be placed in a worse position than he would have occupied had the senior incumbrance not been released. To deny this relief and to refuse to restore for the protection of the first mortgagee the lien of the prior mortgage would be to permit the second mortgagee to unjustly profit by the mistake of the former, or to unconsciously avail himself of the fruits of a palpable fraud perpetrated by another to the injury of the victim of the fraud. *Therefore, a subsequent mortgagee, who becomes such anterior to the discharge of a prior mortgage, cannot, with any show of reason or justice, claim to be injured by the setting aside of the subsequent release and restoring the lien of the prior mortgage. He is in no way prejudiced, but is left to enjoy exactly what he expected to get when he accepted the second mortgage.* *Gieb v. Reynolds*, 35 Minn. 331, 28 N. W. 923; *Bruse v. Nelson*, 35 Iowa 157; *Hutchinson v. Swartsweller*, 31 N. J. Eq. 205; *Robinson v. Sampson*, 23 Me. 388; *Cobb v. Dyer*, 69 Ms. 494; *London & N. W. American Mtg. Co. v. Tracey*, 58 Minn. 201, 59 N. W. 1001; *American Bonding Co. v. National Mechanics' Bank*, 97 Md. 598, 55 Atl. 395, 99 Am. St. 466, note."

This court in the case of *Griffin v. International Trust Co.*, 161 Fed. 48, 88 C. C. A. 212, laid down the rule as adopted by the Supreme Court of Washington in the above case and has forcibly presented the reason for the adoption of this rule, citing authorities in support thereof.

It would be inequitable to declare this mortgage extinguished. The contractors, laborers and materialmen were all inferior to the lien of this mortgage as long as it was in the hands of the insurance company, which was until their debts had all matured, their liens had been filed and this action instituted, and their position has not been changed one particle to their detriment by the assignment.

EACH LIEN CLAIM IS A SEPARATE CONTROVERSY AND MUST STAND UPON ITS OWN MERITS.

The court's attention is called to the decisions of the Supreme Court of the State of Washington to the effect that each claim must stand or fall upon its own merits. Some of the lien claimants are absolutely without right or authority to object to this \$70,000.00 mortgage, and particularly is the McClintic-Marshall Company foreclosed from so doing because of the fact that they entered into their contract when the title to the property was held by the bank. In several other instances no claims or representations as to title, mortgages or money were

made at the time the contracts were entered into, or at any time subsequent thereto. None of the lien claimants testified that they knew anything at all as to the title of the property at any time prior to January 15th, 1921.

We call the court's attention to the fact that because the \$70,000.00 mortgage was of record, it was the duty of all parties intending to rely upon the security of the property to make investigations for the purpose of ascertaining the true facts with reference to the mortgage. We quote the following from 3 Devlin on Real Estate, Sec. 1342:

"RELIANCE UPON RECORD." — As has been explained, the question of merger is one determined in a great measure by the intention of the parties. Reliance cannot be placed upon the record for the purpose of showing merger. A party who takes a deed upon the assumption that there has been a merger of a former mortgage to his grantor, in a subsequent conveyance of the land, acts at his own peril. He has notice that some one holds the mortgage as an existing lien, and, unless the mortgagee is still the owner of the mortgage, the grantee takes subject to it. In a case in Wisconsin the court considered the question of merger, quoting with approval the language of the Master of the Rolls, Sir William Grant, that the question is 'upon the intention, actual or presumed, of the person in whom the interests are united', and adds: 'Such being the law, it seems very clear that it was the duty of the

trustees, if they desired that the trust deed should be unaffected by the plaintiff's mortgage, to go beyond the record in the register's office (for such record was notice to them of the mortgage), and to ascertain from other sources whether there had been a merger in fact. They should have required their grantor (if they could), to produce the mortgage and the note which it was given to secure, and to deliver them up or, at least, to produce the securities and discharge the mortgage of record. The inability of the grantor to do so would be sufficient to charge the trustees with notice that the security had been assigned, and the failure to call upon the grantee to do so is sufficient to charge them with laches. Briefly stated, the case seems to be this: When the trust deed was executed, under which the appellant makes its title to the land in controversy, the plaintiff's mortgage was of record in the proper office, and the trustees had, at least, constructive notice of its existence. There was nothing of record to show that the debt which it was given to secure had been paid, and nothing which could affect the mortgage, except the registry of the conveyance to the mortgagee of the equity of redemption. The record did not show whether such conveyance operated as a merger of the mortgage interest in the land or otherwise. Further investigation was necessary to determine that fact, and the means of determining it were at hand. The trustees failed to push their inquiries beyond the registry. They failed to ascer-

tain (as they easily might have done,) whether the two estates were, in fact, united in their grantor and, if so, whether the latter elected to preserve the mortgage interest. Using no diligence in that behalf, they took their conveyance at their peril of the fact. It turns out that there has been no merger; that the mortgage interest is still subsisting, and because of priority of execution, and registry, such interest is paramount to that of the appellant in the mortgaged premises.' If a mortgagee assigns the mortgage, and if subsequently the mortgagor conveys the mortgaged estate to the mortgagee, the assignee of the mortgage has a valid lien on the property as against a person purchasing from such mortgagee, without knowledge of the assignment. The fact that, prior to the registration of the assignment, the conveyances to the mortgagee, and from him to the purchaser, were both placed on record cannot alter this rule. The records can only show what was done. They cannot show what the parties intended when not expressed. The assignee stands in the place occupied by the mortgagee at the time of the assignment. If the mortgage was a valid lien at that time, it does not lose its validity because subsequently the mortgager conveys the property to the mortgagee. A purchaser cannot assume without inquiry that the mortgage was satisfied."

Miller v. Fryberg et al., 119 Wash. 243, 205 Pac. 388, is particularly called to the court's attention, and we quote at length the following:

"Fryberg and wife, being the owners of the real estate involved herein, in King county, Washington, and desiring to construct a dwelling house thereon, made, executed and delivered to W. J. Byrne their note for \$2,300, payable five years after date, and a first mortgage upon the real estate, maturing five years after date, which instruments were dated February 27, 1920. In consideration of the note and mortgage securing the same, Byrne gave Frybergs no money, but agreed to construct the dwelling, and from the money represented by the note and mortgage pay for all labor and material furnished and used in the construction of the house.

" The mortgage was recorded in the office of the auditor of King county on March 10, 1920. Prior thereto, Byrne had entered into an agreement with the McGillvray Building Company, one of the defendants herein, for the construction of the dwelling house and it proceeded with the construction, but had done nothing prior to the recording of the mortgage. On March 8, 1920, Byrne assigned the note and mortgage given him by Fryberg and wife to respondent, American Savings Bank and Trust Company, a banking corporation, together with other notes and a mortgage received by Byrne from another, receiving the full amount of this mortgage in consideration of the assignment of the notes and mortgages. The bank failed to record its assignment of the mortgage until *December 2, 1920*. The McGillvray Building Company, after it proceeded

with the construction of the dwelling house, purchased lumber to be used therein from appellant Farrell Lumber Company about March 24, 1920, and which lumber was used in the construction of the building.

“The Farrell Lumber Company investigated the title to the property prior to commencing to furnish the materials and discovered the mortgage from Fryberg and wife to Byrne of record, and thereupon refused to furnish lumber to be used in the construction of the building. Thereupon Byrne went to the office of the lumber company and stated that he held the mortgage upon the premises; that the mortgage was given for the purpose of securing funds to construct a dwelling house thereon, and that he had advanced no money to the Frybergs, but intended to use the fund represented by the note and mortgage to pay claims for labor and materials; and to that effect, on March 25, 1920, Byrne addressed and delivered a letter to the Farrell Lumber Company in which he stated that he had made a building loan upon the Fryberg property, describing it, and that he would be pleased to deduct and pay to the Farrell Lumber Company, out of the first mortgage, the amount of its bill, stating that the lot was clear and his mortgage was put thereon for the purpose of advancing money to build, and that he owned the mortgage. Upon receipt of this letter, and on March 26, 1920, the lumber company proceeded with the delivery of the lumber required to

be used in the construction of the building, and ceased to furnish material on June 26, 1920, having furnished a total of the value of \$1,446.95, upon which Byrne had paid the sum of \$500, and after deducting certain credits, the lumber company's claim amounted to \$821.90.

“It is the contention of appellants that, by failing to file its assignment, which would have given notice to materialmen and mechanics that it had acquired Byrne's interest in the Fryberg note and mortgage, the bank permitted Byrne to record the mortgage and defraud the lien claimants by dealing with them as the owner of the mortgage, and that the bank lost its priority as against the subsequent lien claimants by reason of Sec. 8781 Rem. Code (P. C. Sec. 1914). That section is as follows:

“All deeds, mortgages and assignments of mortgages shall be recorded in the office of the county auditor of the county where the land is situated, and shall be valid as against bona fide purchasers from the date of their filing for record in said office; and when so filed shall be notice to all the world.”

“We held in *McDonald & Co. v. Johns*, 62 Wash. 521, 114 Pac. 175, 33 L. R. A. (N. S.) 57, that the above statute should be considered to mean *bona fide* mortgagors or incumbrancers as well as *bona fide* purchasers, and provided protection for all such subsequent to the given conveyance or mortgage; and held in the same case that the statute quoted imposed upon any given mortgagee the duty of mak-

ing a public record of his mortgage for the information and guidance and protection of those who, at a subsequent time, may have occasion to deal concerning the land, failing in the discharge of which duty, he shall lose the priority otherwise to be accorded to him.

✱ In the case at bar, any one dealing with the Frybergs or with the real estate in question and examining the record would find Byrne's mortgage of record. They would find that the lien of the mortgage was ahead of any lien which they could obtain. They obtained no interest in the mortgage and had done nothing in the way of furnishing materials or labor prior to the recording of the mortgage which would give them priority under our lien statutes. Our lien statutes in Rem. Code Sec. 1132 (P. C. Sec. 9709), provided that mechanics' and materialmen's liens shall be ". . . preferred to any lien, mortgage or other incumbrance which may have attached previously to that time, and which was not filed or recorded so as to create constructive notice of the same prior to that time, and of which the lien claimant had no notice." Here the Byrne mortgage had been recorded prior to the furnishing of any labor or materials, and the lien claimants had constructive notice of it. The Farrell Lumber Company had both constructive and actual notice of it. It is claimed that it is in a different position from the other appellants because of the letter which Byrne gave it promising to pay it out of the proceeds of the mort-

gage; but we think it is in no better position than any of the other claimants. It obtained no assignment of the mortgage which it could hold as against the bank's unrecorded assignment. The letter, in fact, was simply a promise to pay out of the proceeds of the mortgage, and the lumber company must have been expecting to obtain its pay out of such proceeds, but from Byrne, not from the bank.

"The law is well settled that:

"Priority once obtained cannot be lost. The registry of a deed or mortgage is equivalent to a notice of it to all persons who may subsequently become interested in the property, and fully protects the grantee's rights. A mortgage having once obtained priority by record does not lose its place by being held by anyone under an unrecorded assignment. And although the mortgagee had notice of a prior unrecorded mortgage, or there are equities such that his own mortgage is in his hands subject to them, yet if he assigns his mortgage for a valuable consideration to one who has no notice of the earlier mortgage or of such equities, the assignee is entitled to hold the mortgage as a prior lien upon the land, solely upon the ground that it was first recorded . . .

"The precedence follows them through any subsequent transfer, or through any proceedings to enforce the liens." Jones on Mortgages (7th ed.), Sec. 525, p. 828.

“

To the same effect are the following authorities: *Curtis v. Moore*, 152 N. Y. 159, 46 N. E. 168, 57 Am. St. 506; *Peoples Trust Co. v. Tonkonogy*, 144 App. Div. 333, 128 N. Y. Supp. 1055; *Nashua Trust Co. v. Edwards Manufacturing Co.*, 99 Ia. 109, 68 N. W. 587, 61 Am. St. 226, 19 R. C. L. Sec. 131, pp. 361-362.

“ (It may be observed that we do not concur with all the reasoning and statements in the Iowa case above cited, for that court there held that lienors and incumbrancers could not be considered as purchasers for value without notice; while we held that they are entitled to protection as purchasers, as heretofore stated.) ”

We have already argued this matter at perhaps too great a length, but it seems advisable to us to review some of the language of the court in its decision because we feel that the decision cannot be justified upon the grounds stated therein.

“Mr. Haskell, as receiver of the bank, not as receiver of the building company, acquired a note and mortgage of the building company for \$70,000.00. This mortgage was outstanding at the time the various contracts relating to the construction of the building were made. The receiver's purpose was to protect the property from foreclosure of the underlying mortgage, and in form it was a purchase by him. The deed from the bank to the building company of this property was a warranty deed. Under these circumstances, the ordinary rule that it would

be inequitable for the court to sanction a receiver's act for the benefit of one set of creditors, and at the same time to the injury of other creditors, lends no support to those now contending for and invoking this rule, for the bank's creditors are not the building company's creditors; nor are the latter bank creditors, and, while Mr. Haskell is receiver of both the bank and the building company, the money used in taking up the mortgage was the bank's, and he was acting as the bank's receiver, out of the control of this court in so doing. If, because of the relation between the bank and building company, it is sought to apply such a rule upon all equitable considerations, it can be invoked rather by the lien claimants than by the bank's receiver."

Is it not patent that the court is confusing the duties of a receiver with that of a bank commissioner liquidating the bank as a state officer? The bank commissioner was not in any manner representing the creditors of the building company and was not acting for and in behalf of two contesting sets of creditors. It is true that "the money used in taking up the mortgage was the bank's, and he was acting as the bank's receiver, out of the control of this court in so doing", as stated in the opinion, but this does not follow that the equities of the case could be resolved in favor of the lien claimants of the building company as against the creditors whom the bank commissioner represented.

The court further says, "the deed from the bank to the building company being a warranty deed, if the lien claimants were not in privity with the owner, so that they could maintain suit against the bank when the warranty, the building company and its receiver could maintain such a suit, and anything realized therefrom could be subjected to judgments recovered by the lien claimants."

What would it avail the building company to institute a suit against the bank upon the warranty? It would be met on the threshold of a court of equity, with its cardinal principles that he who comes into equity must come with clean hands, and he who seeks equity must do equity. And we believe it could obtain relief only upon the express direction that if it sought to have the bank satisfy this mortgage it would have to live up to all of the terms and conditions of the contract pursuant to which it obtained its title, then we submit the pertinent question, What would be realized therefrom for the lien claimants?

The court also says, page 170: "The bank's receiver in taking up this mortgage was merely seeking to prevent a further increase of claims against the trust estate in his hands, which, if suffered, would result in the dilution of the assets and could not but prejudice the depositors and other creditors of the bank. Under these circumstances, to hold the bank receiver's action in taking up the underlying mortgage a purchase, whereby he accepted liability

upon the warranty and also secured a position of advantage where he could defeat the lien claimants, not only has no equity in it, but would be highly inequitable." We maintain that this statement and the conclusions based thereon are not warranted by the real facts. To refuse to pay this mortgage certainly would not "result in the dilution of the assets, etc." It seems elementary that the building company could not enforce the payment of this mortgage by the bank, and if it could not do so we are at a loss to see how its lien claimants could do so. Also, how could he defeat the lien claimants? Their equity would in no manner be disturbed or relegated to a worse position than that which they occupied when this action was instituted. The court has entirely ignored the equity of the bank, which arose in its behalf when the building company breached the contract pursuant to which it obtained title to the premises in controversy.

The court's ruling illustrates the danger of a court attempting to impute an intention contrary to the express acts and declarations of the parties.

It also violates the rules that administrative officers such as bank commissioners exercising quasi-judicial functions cannot be questioned in matters which by statute they are called upon to decide.

Meechem, Public Officers, Sec. 640;

2 Cooley on Torts, 797;

Throop, Public Officers, 720-1;

29 Cyc. 1432-3; 1442-3-4.

The following part of the court's decision is also noted: "The breach of the warranty and uncertainty arising therefrom may have been one of the causes preventing the issuance and delivery of such bonds." The court in making this statement apparently overlooked the fact that the contract called for the delivery of the bonds by June, 1920, and that the mortgage was not due and payable until September, 1920, four months thereafter.

The court also says, "it is not necessary to consider the inconsistency of the bank's receiver's positions in asserting the \$600,000.00 mortgage based on a title warranted by the bank and at the same time asserting the \$70,000.00 mortgage, the existence of which breached the warranty on which the value of the \$600,000.00 mortgage rested. The right of subrogation is an equitable right, and there is no equity in such a contention."

This statement can only be justified by an unqualified holding that the bank commissioner of the State of Washington was acting in the capacity of a receiver and not that of a state official, and in totally ignoring any equity on the part of the bank arising from the fact that it gave its property away without any consideration whatever, due to the breach of conditions of the contract by the building company.

It is true that the right of subrogation is an equitable right, but in its exercise a court must give due consideration to all equities arising out of the

circumstances of a particular transaction. The doctrine of subrogation is broad enough to include this transaction between the bank and the building company, and to protect the rights of the bank against any claim to be asserted by the building ~~of its~~ *company* creditors.

Among the assets which came into the hands of the Supervisor of Banking was the purchase money agreement and the \$600,000.00 mortgage executed by the building company and thereafter assigned to the bank. It was, therefore, not only the right but the duty of the Supervisor of Banking to protect the apparent securities in his hands for the benefit of the creditors whom he represents, and having done so, it would be most unjust and inequitable for the court to misconstrue his actions into the granting of an illegal preference out of the funds in his hands to the creditors of the building company. That would be the only effect of the extinguishment of the debt by judicial construction — the creditors of the building company will have been paid \$70,000.00 out of the assets in the hands of the Supervisor for the benefit of the creditors and depositors of the bank. It seems to us, therefore, that had it been the intention of the Supervisor to pay this mortgage, the circumstances are such that this court, sitting as a court of equity, would revive the lien of the first mortgage for the benefit of the creditors whom the Supervisor represents.

“It is sufficient that the payment be made in performance of a supposed legal duty and in good faith, even though the party making the same were not really bound.”

5 Pomeroy Equity, 5190-1.

We therefore conclude that the bank commissioner is not appointed by nor responsible to any court and has not the status of a judicial receiver, and is not an agent of the bank taken in charge for the purpose of liquidation, and his acts are not to be construed as the acts of the bank. The mortgage is a valid lien upon the premises, entitled to priority over every other lien and claim asserted in this action, and the decree of the court should be reversed with directions to allow the foreclosure of the mortgage as a prior lien.

VALIDITY OF THE \$600,000.00 MORTGAGE.

The court will recall from our statement that this mortgage was executed in compliance with the terms of the contract pursuant to which the building company obtained title to the premises. It agreed with the bank, in consideration of the bank's conveying title to the premises, to erect a sixteen-story building on said premises, “to borrow \$600,000.00 and execute therefor a first mortgage on said premises and in addition thereto to issue second mortgage bonds against said premises . . .”, which said mortgage must be executed and recorded before ac-

tual construction shall begin, also to lease the bank the ground floor for banking purposes (Ex. 181, Tr. 105). The salient facts with reference to this mortgage seem to be that the bank deeded its property to the building company upon a written agreement to the effect that the building company would erect a building upon the premises conveyed to it by the bank and a part of said building would be used and occupied under a lease by the bank; the building company agreed to place a \$600,000.00 mortgage upon the property, and also to execute a bond issue for \$750,000.00, of which issue the bank should receive \$350,000.00 of those bonds in payment of the building site obtained from the bank. Pursuant to this agreement the property was deeded to the building company and the building company thereupon executed a \$600,000.00 mortgage and attempted to secure a loan by means thereof. It failed, however, to take any steps leading to the execution of the bond issue.

The evidence fully sustains the conclusion that the bank was not to advance any of its money for the purpose of constructing the building. Mr. Larson's testimony in that respect was completely overwhelmed by that of every other officer of the bank and also by Mr. Larson's own letters and communications. The bank funds were, however, used in spite of the objection of the state bank commissioner and other officers of the bank.

Within three or four days after the bank commissioner had warned Mr. Larson against putting any of the bank's money into the building company, Mr. Larson advanced \$200,000.00, which he afterwards claimed was for the purchase of the capital stock of the building company. It will be recalled that the trustees of the bank testified that there was no authorization for Mr. Larson's acts in that respect. It will also be recalled that in December, 1920, Mr. Larson ordered an entry upon the books of the bank charging interest on this amount as a loan or interest item. In June the time expired within which the building company was to have given the bank bonds to the amount of \$350,000.00 as per contract.

At about this same time Mr. Sheldon, Mr. Drury and Mr. Johnston, trustees of the bank, began to insist that the \$600,000.00 mortgage be assigned to the bank to protect the bank for the amount already due it. Shortly thereafter Mr. Larson went East with the mortgage, the mortgage note and other papers and met Mr. Simpson, and being unable to obtain an advance on this mortgage had the mortgage assigned to the bank on October 7th, 1920. In December, 1920, under Mr. Larson's express directions, loans already made to the bank were placed as secured by this mortgage. At various times interest charges were made under Larson's directions against the building company on the amount advanced to the company, upon the \$200,000.00 so-

called stock transaction and upon the \$350,000.00 purchase price for the lots, and the mortgage was used as security therefor. The acts of the bank showed conclusively its intention of holding this \$600,000.00 mortgage as security for advances made by the building company. Entries of like import were made on the books of the building company.

We also call attention to the fact that at the time Larson was trying to obtain money on this \$600,000.00 mortgage and before he had obtained an assignment to the bank the insurance company had suggested the use of this mortgage for obtaining temporary loans; in one of their communications they stated that with the insurance company's commitment and the mortgage on record they should have no difficulty in obtaining such a loan. The entire transaction upholds our contention that this mortgage was assigned to the bank in order to protect the interests of the bank.

It cannot be argued that this mortgage was without consideration when the bank had a valid binding contract to the effect that this mortgage should be executed and a loan placed thereon in order to protect the bank's interest in the lots conveyed to the building company. The evidence, therefore, establishes the fact that this mortgage was a valid mortgage from the time of its execution, being founded upon a sufficient consideration, the conveyance of the property, and that the bank advanced upon the security of the mortgage a sum of money

in excess of \$500,000.00. The building company owed the bank on January 15th, 1921, the sum of \$856,879.67.

This mortgage was of record prior to the time that any of the claims urged in this suit had their inception, and most of the lien claimants had actual notice that this mortgage was either of record or was to be placed on record, and all of them had legal notice that this mortgage was prior to any claim that they might thereafter acquire against the property, and most of them waived their right of lien in order to give this mortgage unquestionable priority.

We cite the following authorities as to the validity of this mortgage which was executed for the purpose of securing future advances to be used in the construction of the building:

The Seattle, 170 Fed. 284, 95 C. C. A. 480;

Shirras, 3 U. S. 260;

Lawrence v. Tucker, 23 Howard 14, 16 L. Ed. 474;

Kneeland v. American Loan & Trust Co., 136 U. S. 89, 34 L. Ed. 379;

Jones v. New York Guaranty & Indemnity Co., 101 U. S. 622, 25 L. Ed. 1030;

Alice Chalmers Co. v. Central Trust Co., 190 Fed. 700;

Jahn & Co. v. Mortgage Trust & Sav. Bank, 97 Wash. 504, 166 Pac. 1137;

Huttig Bros. etc., Co. v. Denny Hotel Co., 5 Wash. 122, 32 Pac. 1073;

Home Savings & Life Ass'n v. Burton, 20 Wash. 688, 56 Pac. 940;

Heal v. Evans Creek Coal and Coke Co., 71 Wash. 225, 128 Pac. 211;

Keene Guaranty Sav. Bank v. Lawrence, 32 Wash. 572, 73 Pac. 680;

Cuttlar v. Keller, 88 Wash. 334, 153 Pac. 15;

Fitch v. Applegate, 24 Wash. 25, 64 Pac. 147;

Olson v. Smith, 84 Wash. 228, 146 Pac. 572;

Schmidt v. Cahrndt, 47 N. E. 335;

Blackmar v. Shark, 50 Atl. 852;

Andersonian Inv. Co. v. Jones, 104 Wash. 142, 176 Pac. 17.

In *Huttig Bros. etc., Company et al. v. Denny Hotel Company et al.*, 6 Wash., 122, 32 Pac. 1073, which case has been frequently referred to and followed in subsequent decisions of the Supreme Court of Washington, one of the questions presented to the court for decision was the contention that because the principal contractor had entered into a contract for the construction of a hotel, and had commenced work thereunder prior to the execution of the mortgage, he was entitled to maintain a lien paramount to the mortgage lien and that the said lien should relate back to the time of the making of the original contract. The Supreme Court refused to sustain this contention, saying (page 130 of the decision), "But the lien can hardly date from the time appellant commenced the preparation of the

materials in another state. It was to furnish the materials delivered at the building in the City of Seattle, and its claim cannot be held to have attached before the delivery thereof." Also, "Under the provisions of our statutes a materialman can only claim a lien from the time he commenced to furnish materials for the building, and such time is subsequent to the creation of the mortgage lien of which he had notice his claim for materials is subject thereto."

We quote also the following:

"The hotel building in question was in process of construction at the time of the execution of this mortgage, and the money was borrowed with the understanding that it was to be used in putting up the building, and it is contended by appellant that its claim for materials furnished should be held prior to the mortgage lien for these reasons.

"Sec. 1666, Gen. Stat., provides that the liens authorized in that chapter are preferred to any lien, mortgage or other incumbrance which may have attached subsequently to the time when the building, improvement or structure was commenced, work done, or materials were commenced to be furnished, etc. It is contended in this case that, as the principal contractor had entered into the contract work thereunder prior to the execution of the mortgage, he would have had a lien paramount to the claim, and that, consequently, appellant's lien should re-

late back to the time of the making of the original contract.

“Sec. 1663 provides that every person performing labor upon or furnishing materials to be used in the construction of any building, etc., has a lien upon the same for the work or labor done, or materials furnished by each, respectively, etc., and this seems to contemplate that each lien shall stand upon its own footing. Consequently, appellant is not in a position to claim the right to be subrogated to the rights of the contractor in this particular, even if he could have enforced a lien including a claim for the materials furnished by appellant as paramount to the mortgage lien, without having paid said claim or making such materialman a party to the suit, if the time within which he could claim a lien for materials had not expired, which we do not decide. See *Crowell v. Gilmore*, 18 Cal. 370.” . . . “Under the provisions of our statutes a materialman can only claim a lien from the time he commenced to furnish materials for the building, and if such time is subsequent to the creation of the mortgage lien, of which he has had notice, his claim for materials is subject thereto.” . . .

“It is also urged by the appellant that, by reason of the testimony given to the effect that the Denny Hotel Company borrowed this money for the purpose of building the hotel, and that the Cornell University had notice of that fact, and sought to protect itself in the mortgage against any liens that might

be created against the property by reserving the right to pay the same from the amount of the mortgage loan, it is estopped from disputing the claims of the lienors. The authorities are against this proposition, however. The respondent had a right to consider and contemplate the making of improvements upon the property as a basis for making the loan in question. And by seeking to protect itself in the mortgage against liens which might be enforced against the property, it cannot be held to have become a party thereto, or to have assumed any liability as to such liens. The provisions were inserted merely for its own protection. *Platt v. Griffith*, 27 N. J. Eq. 207; *Moroney's Appeal*, 24 Pa. St. 372; *Monroe v. West*, 12 Iowa, 119; *I Jones on Mort.* § 370."

Home Savings and Life Association v. Burton, 20 Wash. 688, 56 Pac. 940, contains a more elaborate discussion of the priority of a mortgage to secure future advances over liens and very clearly and forcibly holds, as stated in the syllabus, that "a mortgage to secure future advances is entitled to priority over the liens of mechanics and materialmen, if recorded prior to the performance of service or furnishing of materials, even if a portion of the advances are not made until after the mechanics have attached under General Statute, Sec. 1666, according mechanics' liens preference to any lien or mortgage which may have attached subsequent to the time when the building was commenced, work done,

or materials furnished, or which was unrecorded at that time, or of which the lien-holder had no notice at the commencement of furnishing services or materials." The trial court held the mortgage valid only as to advances made prior to beginning of work. This ruling was reversed.

The court uses the following language on page 696:

"It would seem that, under the provisions of this statute and the authorities cited, it could hardly be doubted that appellant's mortgage is prior and superior to the liens of these respondents. But it is nevertheless claimed by the learned counsel for Carson, Davis and Julian and George P. Howard that a mortgage to secure future advances becomes an actual charge upon the land covered by it at the time when such advances are actually made, and then only to the amount of the advances; that, until the advances are made, neither the land described in the mortgage, the parties to it, nor third persons, are bound by it, and that the record of such mortgage cannot operate as constructive notice to subsequent incumbrancers. And in support of their position counsel cite the following cases: *Ladue v. Detroit & M. R. R. Co.*, 13 Mich. 380 (87 Am. Dec. 759); *Schultze v. Houfes*, 96 Ill. 335; *Ter-Hoven v. Herns*, 2 Barr. 96; *Bank of Montgomery County's Appeal*, 35 Pa. St. 170; *Spader v. Lawler*, 17 Ohio 371 (49 Am. Dec. 463); *Boswell v. Goodwin*, 31 Conn. 74 (81 Am. Dec. 169)."

“It is urged with much earnestness that appellant’s mortgage never attached, or, in other words, did not become a lien as against these respondents, except as to the first advancement made thereunder, for the reason that work was commenced by the contractor upon the building and certain materials furnished therefor, before any of the subsequent advances were made. It must be admitted that the authorities cited afford a legitimate basis for the argument, but we are not disposed to adopt the rule contended for as the law of this state. These cases are against our judgment, based upon an erroneous view as to the real nature of equitable liens, and the effect of our recording acts. These very cases were reviewed and the doctrines announced by them clearly pointed out by Pomeroy in his valuable treatise on Equity Jurisprudence. Referring to them and other cases holding the same view, he says:

“ ‘They seem to regard the lien for securing future advances as only arising, or at all events as only perfected so as to be available, at and from the time when the advance is actually made. An advance, therefore, although in pursuance of a prior mortgage duly recorded, if made after the record of a subsequent mortgage or conveyance, or the docketing of a subsequent judgment, is affected with constructive notice of such subsequent encumbrances or conveyance, and its lien is consequently postponed to that of second record. By this rule, a mortgage to secure future advances secures a preference only

for those advances, actually made before the record of a subsequent encumbrance or conveyance; it loses its precedence for all advances made after such record.' ”

“The learned author then expresses his own opinion in the following language:

“ ‘The fundamental error of this view, in my opinion, consists in its mistaken conception of the nature of an equitable lien, in regarding the lien as arising at and from the act of making the advance, instead of from the previous executory agreement by which the land was bound as security for the future advances.’ 3 Pomeroy, Equity Jurisprudence (2nd Ed.) § 1199, and note.

“See, also, 1 Jones, Mortgages (5th Ed.), § 372.

“Mortgages to secure future advances have always been sanctioned by the common law In this country, mortgages made in good faith for the purpose of securing future debts have generally been sustained, both in the early and in the recent cases. It does not matter that the future advances are to be made to a third person or for his benefit at the request of the mortgagor. Neither is the validity of a mortgage to secure future advances affected by the fact that the advances are to be made in materials for building instead of money. A mortgage is not fraudulent because it is given for a larger amount than the actual loan made at the time, with a view to its covering future loans up to the amount of the mortgage.” 1 Jones Mortgages (5th Ed.), § 365.

“ ‘Claimants of liens’, says Mr. Phillips, ‘are bound to know what has been done under a duly registered mortgage. Mortgages, and deeds in the nature of mortgages, to secure future loans or advances, if *bona fide*, have always been sanctioned, and if otherwise unexceptionable, their validity cannot be questioned. The mere fact that materials are to be supplied, instead of money, will not impair their validity, and, if given before the commencement of a building, will be good against mechanics’ liens.’ ” Phillips, *Mechanic’s Liens* (3rd Ed.), § 236.

“This court recognized the validity of such mortgages in the case of *Huttig Bros. Mfg. Co. v. Denny Hotel Co.*, *supra*. There being no doubt, then, that mortgages to secure future advances are valid liens, we think that, under our statute, they are just as effectual against subsequent incumbrances as are mortgages to secure a present indebtedness. A mortgage given in part to secure future advances was under consideration in the well-considered case of *Tapia v. Demartini*, 77 Cal. 383 (19 Pac. 641, 11 Am. St. Rep. 288), in which the court says:

“ ‘It is firmly settled by a long line of decisions that a mortgage, made in good faith to cover future advancements, is valid, not only as between the immediate parties to the instrument, but as against subsequent purchasers or encumbrancers, if properly recorded.’ ”

“Many cases are cited by the court in support of its declaration, among which is *Shirras v. Caig*, 7

Cranch 34, which is a case entitled to much weight, not only on account of the learning and ability of the court which rendered the decision, but by reason of the fact that the question was determined upon the general principles of equity, without reference to any statutory provision such as we have in this case. The mortgage considered in this California case was, like the one under consideration here, for a specific sum, and did not disclose upon its face that it was given in part for future advancements; but the court held that it was not invalid on that account. In the same case the court further observed:

“ ‘The mortgage, as against subsequent encumbrancers, becomes a lien for the whole sum advanced from the time of its execution and not for each separate amount advanced from the time of such advancement, although the right to enforce the collection thereof can only arise upon each advancement being made.’ ”

In *Heal v. Evans Creek Coal and Coke Company*, 71 Wash. 225, 128 Pac. 211, the court, in holding that a mortgage to secure future advances is valid and takes precedence over laborer's liens for services performed after the mortgage is recorded, says:

“It is next objected that the advancements made to the use of the mortgagor by the mortgagee and his assignees thereunder were not secured by the security clause in the mortgage, and that hence the

court erred in allowing these sums as a part of the mortgage debt. The mortgage clearly provided for future advances on the part of the mortgagor, and for the security of such advances by the mortgaged property. Such mortgages are valid in this state, and create a priority of lien over that of mechanics and materialmen, if recorded prior to the performance of the services or the furnishing of the materials for which the lien is claimed, even though the advancements be made subsequent to the time the liens are filed. *Home Sav. & Loan Ass'n v. Burton*, 20 Wash. 688, 56 Pac. 940. In this case the advancements were made prior to the performance of the services for which the liens are claimed, and for a much stronger reason are prior thereto."

In *Keane Guaranty Savings Bank v. Lawrence*, 32 Wash. 572, 73 Pac. 680, the court held that a mechanic's lien was inferior to that of a prior recorded mortgage, although the contract for furnishing material was entered into prior to the recording of the mortgage; the following language is cited:

"Appellant claims that he acquired a good title to the lots under the foreclosure by Whittier, Fuller & Co. of their mechanic's lien thereon. But the evidence shows that materials were not furnished for use in the building until March 14th, 1890, while respondent's mortgage had been of record since December 23rd, 1889. It is true the contract for furnishing this material was entered into in September, 1889, but the date of the actual furnishing of the

material governs the inception of the lien. *Huttig Bros. Mfg. Co. v. Denny Hotel Co.*, 6 Wash. 122 (32 Pac. 1073); *Home Savings & Loan Ass'n v. Burton*, 20 Wash. 688 (56 Pac. 940). Under these decisions the lien of the materialmen was clearly inferior to that of the mortgage."

In *Cuttler v. Keller*, 88 Wash. 334, 153 Pac. 15, the court held a mechanic's lien inferior to the lien of a prior real estate mortgage, recorded prior to the commencement of the furnishing of the labor or material, under Rem. Code, Sec. 1132, and in construing that section of the statute said:

"The language of this section carries the necessary implication that the lien accorded to mechanics and materialmen is subject to the lien of a prior mortgage on the real estate recorded prior to the commencement of the performance of the labor or the furnishing of the material, or of which the lien claimant had notice. We have uniformly so construed it. *Home Savings & Loan Ass'n v. Burton*, 20 Wash. 688, 56 Pac. 940; *Baker v. Sinclair*, 22 Wash. 462, 61 Pac. 170; *Fitch v. Applegate*, 24 Wash. 25, 64 Pac. 147; *Averill Mach. Co. v. Albritton*, 51 Wash. 30, 97 Pac. 1082."

NO NECESSITY FOR STATING OBJECT OF MORTGAGE.

In *Shirras v. Craig*, 7 Cranch 50, 3 U. S. (3 L. Ed.) 260, it was said by Chief Justice Marshall:

"It is true that the real transaction does not appear on the face of the mortgage. The deed pur-

ports to secure a debt of £30,000 sterling due to all the mortgagees. It was really intended to secure different sums, due at the time for particular mortgages, advances afterwards to be made, and liabilities to be incurred to an uncertain amount. It is not to be denied that a deed which misrepresents the transaction it recites, and the consideration on which it is executed, is liable to suspicion. It must sustain a rigorous examination. It is certainly always advisable fairly and plainly to state the truth. But if, upon investigation, the real transaction shall appear to be fair, though somewhat variant from that which is described, it would seem to be unjust and unprecedented to deprive the person claiming under the deed of his real equitable rights, unless it be in favor of a person who has been, in fact, injured and deceived by the misrepresentations.' ”

In *Lawrence v. Tucker*, 23 Howard 14, 16 L. Ed. 474, the Supreme Court of the United States held that parol evidence was admissible to prove that a mortgage and note for \$5,500.00 and future advances not to exceed in all an indebtedness of \$6,000.00 was intended to secure advances up to \$11,500.00, and that a mortgage for existing debts and future advances was valid. The following quotation from the decision is called to the court's attention:

“An objection of this kind was made in the case of *Shirras v. Caig*, 7 Cranch 34; but this court then said: It is true the real transaction does not appear

on the face of the mortgage; the deed purports to have been a debt of £30,000, due to all of the mortgagees. It was really intended to have different sums due at the time to particular mortgagees, advances afterwards to be made, and liabilities to be encountered to an uncertain amount. After remarking that such misrepresentations of a transaction are liable to suspicion, Chief Justice Marshall adds:

“‘But if, upon investigation, the real transaction shall appear to be fair, though somewhat variant from that which is described, it would seem to be unjust and unprecedented to deprive the person claiming under the deed real equitable rights, unless it be in favor of a person who has been in fact injured and deceived by the misrepresentation.’ In this case the complainant has not been deceived, and the variance between the alleged indebtedness and that advances were to be made afterwards gives to his suit no additional force or equity.”

“No proof was given by the complainant that he had been injured or deceived by it into making his purchase under the mortgages of Briggs and Atkins, and that cannot be presumed in his behalf. In fact there is not an averment in the complainant’s bill in favor of the equity of his demand, which is not met and denied in the defendant’s answer, and which has not been disproved by competent testimony. We do not think there is anything in the objection that the mortgage to H. A. Tucker to se-

cure future advances by the firm of H. A. Tucker & Co. cannot stand as security for advances made after the admission of new partners into that firm. The cases cited in support of this objection do not sustain it, and we have not been able to find any one that does. They relate exclusively to stipulations for an advancement of money to a copartnership after a new member has been taken into the firm."

"In respect to the validity of mortgages for existing debts and future advances, there can be no doubt, if any principle in the law can be considered as settled by the decisions of courts. This court has made three decisions directly and inferentially in support of them: *U. S. v. Hooe*, 3 Cranch 73; *Conrad v. Atlantic Insurance Company*, 1 Pet. 448; *Shirras v. Caig*, 7 Cranch 34. Tilghman, Ch. J., says, in *Lyle v. Ducomb*, 5 Binn. 590, 'There cannot be a more fair, *bona fide* and valuable consideration than the drawing or indorsing of notes at a future period, for the benefit and at the request of the mortgagors; and nothing is more reasonable than the providing a sufficient indemnity beforehand.' Mr. Justice Story declared, in *Leeds v. Cameron*, 3 Summ. 492, that nothing can be more clear, both upon principle and authority, than that at the common law a mortgage, *bona fide* made, may be for future advances by the mortgagee as well as for present debts and liabilities. I need not do more upon such a subject than to refer to the case of *The*

U. S. v. Hooe, 3 Cranch 73, and *Conard v. Atlantic Insurance Company*, 1 Pet. 448.”

In *Jones v. N. Y. Guaranty & Indemnity Co.*, 25 L. Ed. 1030, 101 U. S. 622, it is said:

“A mortgage for future advances was recognized as valid by the common law. *Gardner v. Graham*, 7 Vin. Abr. 22, pl. 3. See, also, *Brinkerhoff v. Marvin*, E Johns (N. Y.) ch. 320; *Lawrence v. Tucker*, 23 How. 14.

“It is believed they are held valid throughout the United States, except where forbidden by the local law.”

In the case of *The Seattle*, 170 Fed. 284, the Circuit Court of Appeals for the Ninth Circuit held that where by the terms of a mortgage it was made optional with the mortgagee whether to make or refuse future advances, such future advances were within the lien of the mortgage and prior to that of a second mortgage, if made by the first mortgagee without actual notice of the second encumbrance, which was not imported by the recording of the second mortgage.

This decision is a complete answer to arguments already presented against the validity of the \$600,000.00 mortgage, and we call the court's attention to the following language of Judge Gilbert:

“The principal question is whether the appellee's mortgage shall be held to cover advances made by the bank after the date of the appellant's mortgage. The mortgage to the bank is in the form of a bill of

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“The principal question is whether the appellee's mortgage shall be held to cover advances made by the bank after the date of the appellant's mortgage. The mortgage to the bank is in the form of a bill of

sale, and is given 'in consideration of the money heretofore advanced . . . for the construction of the dredge hereinafter mentioned, and such further advances as may hereafter be made.' Neither the amount so advanced, nor the amount thereafter to be advanced, is stated in the instrument. If Watt had not been a party to that bill of sale, and were not chargeable with full notice of the sum which had been advanced by the bank, very different questions might be presented; but he is to be charged with notice that at that date the bank had advanced \$50,517.35, and, although the limit of future advances was not fixed, there can be no question that, so far as the rights of Watt as a second incumbrancer are concerned, the mortgage was sufficiently definite to protect the bank on its account with the bridge company, on which, from time to time, credits and debits were made, up to the amount which was due the bank at the time when the mortgage was made. Except in one or two states, where it is prohibited, a mortgage may be made to secure future advances to the mortgagor, which shall become a first lien for the amount actually loaned, although a part or all thereof be not advanced until after a subsequent lien shall have attached; and such is the law in the State of Washington. *Home Savings & oLan Ass'n v. Burton*, 20 Wash. 688, 56 Pac. 940. But where, by the terms of the first mortgage, as in this case, it is made optional with the mortgagee whether to make or refuse future ad-

vances, there is some diversity of decision on the question whether he will be protected beyond the sum which he shall have actually loaned or advanced at the date when a junior lien is placed of record. By the decided weight of authority, however, and we so hold, such future advances, although optional, are within the lien of the mortgage, and prior to that of a second mortgage if they were made without actual notice of the second incumbrance, and the recording of a second mortgage does not import notice to the first mortgages. *Ackerman v. Hunsicker*, 85 N. Y. 43, 39 Am. Rep. 621; *Shirras v. Caig*, 7 Cranch 34, L. Ed. 260; *Tapia v. Demartini*, 77 Cal. 383, 19 Pac. 641, 11 Am. St. Rep. 288; *Savings & L. Society v. Burnett*, 106 Cal. 514, 39 Pac. 922; *Davis v. Carlyle*, 142 Fed. 106, 73 C. C. A. 330; *Heintze v. Bentley*, 34 N. J. Eq. 562; *Rowan v. Sharks Rifle Mfg. Co.*, 29 Conn. 282; *McDaniels v. Colvin*, 16 Vt. 300, 42 Am. Dec. 512; *Frye v. Bank of Ill.*, 11 Ill. 367; *Ripley v. Harris*, 3 Biss. 199, Fed. case No. 11853; *Anderson v. Liston*, 69 Minn. 82, 72 N. W. 52; *Schmidt et al. v. Zahrndt*, 148 Ind. 447, 47 N. E. 335 and cases there cited."

In *Allis-Chalmers Co. vs. Central Trust Co.*, 190 Fed. 700 at p. 705, the court used the following language:

"Apparently the framers of the statute did not contemplate the impairment of the ordinary relation of mortgagor and mortgagee. The fact that the bonds were issued for the purpose of raising

funds to improve the mortgaged property does not create an equitable estoppel against the mortgagee and bondholders to prevent them from claiming that their mortgage gives a prior lien. *Dunham v. Railroad Co.*, 1 Wall. 254, 17 L. Ed. 584; *Thompson v. Railroad Co.*, 132 U. S. 69, 10 Sup. Ct. 29, 33 L. Ed. 256; *Porter v. Pittsburgh Co.*, 120 U. S. 649, 7 Sup. Ct. 1206, 30 L. Ed. 830; *Toledo, etc., R. R. Co. v. Hamilton*, 134 U. S. 296, 10 Sup. Ct. 546, 33 L. Ed. 905; Jones on Liens, § 1458.

“Whoever undertakes construction work upon property subject to a recorded mortgage must be assumed to have relied upon the personal responsibility of the other party to the contract and upon such liens as the statute grants in definite terms, and not upon the expectation of displacing the priority of mortgage liens. The argument that there is some sort of superior equity in claims for work and materials over liens for money previously advanced upon mortgage is without merit, and the chancellor cannot apply such a principle either to displace vested liens or to broaden a lien statute by the construction which disregards absolutely the rights in a mortgage security. *Kneeland v. American Loan Co.*, 136 U. S. 89, 97 *et seq.*, 10 Sup. Ct. 950, 34 L. Ed. 379.”

In *Jahn & Co. v. Mortgage Trust & Sav. Bank*, *supra*, the Supreme Court of Washington held, as set forth in the syllabus, as follows:

“Where the contractor, at the time of entering into the contract, knew that a mortgage was to be given as a prior lien to raise money to pay for the work, the mortgage is prior to the claims of the contractor, although work was commenced before the mortgage was executed and filed, notwithstanding Rem. Code, Sec. 1132, providing that a mechanics’ lien is preferred to any incumbrance attaching subsequent to the commencement of the work.

“Under Rem. Code, Sec. 1132, providing that a mechanics’ lien is preferred to any incumbrance attaching subsequent to the commencement of the work for which the lien is given, a mortgage given to raise money to pay bills and expenses incurred in the progress of the work, but filed subsequent to the commencement of work on the building, is superior to claims for materials furnished to the contractor long after the mortgage was made and recorded.”

The rule is thus stated in the various text books:

In 15 Am. and Eng. Enc. Law, p. 801, the rule is stated as follows:

“When the mortgage on its face gives such information as to the purpose and extent of the undertaking of the mortgage that any one interested may, by the use of ordinary diligence, ascertain the extent of the incumbrance, then the better view seems to be that the mortgage will have precedence over subsequent incumbrances as to all advances

made within the terms of a mortgage, whether made before or after such junior incumbrance, even though the extent of the contemplated advances is not limited, and whether the mortgagee be bound to make the advances or not."

In Pom. Eq. Jur., § 1199, it is stated as follows:

"The prior mortgage, therefore, duly recorded, has a preference over subsequent recorded mortgages or conveyances, or subsequent docketed judgments, not only for the advances previously made, but also for advances made after their recording or docketing without notice thereof. As the record of the second incumbrance does not operate as a constructive notice, it requires an actual notice to cut off the lien of the prior mortgage; and the subsequent incumbrancer may, by giving actual notice, at any time prevent further advances from being made to his prejudice."

In 27 Cyc. 1069 the following statement is found:

"Future Advances: A mortgage may be made as well to secure future advances or loans of money to be made by the mortgagee to the mortgagor as for a present debt or liability, and if executed in good faith it will be a valid security. It may also be made to cover the value of goods thereafter to be sold to the mortgagor, or for the payment of future accruing accounts between the parties, and is equally valid, although the advances are to be made in building materials in lieu of money. Nor is it essential that the mortgage should be absolutely bound

to make the contemplated advances; between the original parties at least the mortgage will be a valid security, although the making of the advances was left to his option or discretion. And the validity of the mortgage is not necessarily impaired by the fact that it does not show upon its face the real character of the transaction; although it recites an existing debt as its consideration, it may be shown that it was intended to cover future advances, and the mortgagee can recover the amount actually advanced up to the time of enforcing the security, but the mere fact that the mortgage was given to secure future advances, while it recites a present debt, or that it was given for a larger amount than was loaned at the time, and with a view of covering future loans, is not conclusive of fraud."

In 19 Ruling Case Law, p. 429, § 210 thereof is as follows:

"The record of a mortgage to secure future advances is notice to all subsequent incumbrancers as to advances made before their incumbrances. Such a mortgage is protected by the bankruptcy law, and, to the extent of the advances actually made, is good as against an assignee in bankruptcy. All the adjudications appear to agree that, in the absence of notice of an inferior lien, the holder of security for future advances may continue to treat the property as free from subsequent incumbrance, and therefore can safely make further loans to the debtor. His prior equity under the mortgage is superior to the

subsequent equity of one who holds a later lien as to all advances made in ignorance of such subsequent incumbrance, whether made before or after it attaches to the property."

1 Jones on Mortgages § 375, at p. 525, the following statement of the law is set forth:

"The agreement under which advances to a certain amount are to be made need not be in writing, to be binding and effectual against subsequent liens, when it has been acted upon. Thus, if a mortgage is made to secure future advances to be used in the construction of a building on the mortgaged land, and a mortgage for the contemplated amount is made and recorded, it has priority against a mechanic's lien for materials furnished in the construction of such building to the full amount of the mortgage, if the advances are actually made to that amount, although the agreement under which they are made is verbal only." And cases therein cited.

We call the court's attention particularly to the case of *Blackmar v. Shark*, 50 Atl. 852, in which the Supreme Court of Rhode Island held in a case where a mortgage to secure future advances was executed to a person who paid no consideration therefor, and which was subsequently transferred without consideration to a third person, with the understanding and agreement that such third person should make advances in installments to the mortgagor as the building of certain houses progressed, and in which case the *mortgage was not*

transferred until after lien claimant had commenced work on such building, that the mortgage was valid from the date of its execution and recording, entitling the said third party to priority over the said lien claimant.

Practically all of the lien claimants had actual knowledge of the existence of this mortgage, and waived their right of lien so that this mortgage might stand unimpeachable by them. Of course it is elementary that the lien waiver's clause would mean nothing except in case of a breach of their contract, so it must be held that all the parties had in mind the possibility of the failure of the building company to perform the terms of the contracts it had with the lien claimants. Having thus agreed, and with full knowledge that the mortgage was to be used for the purpose of obtaining money with which to construct the building, their rights must be held to be subordinate to that of the mortgage.

Jahn & Co. v. Mortgage Trust & Sav. Bank,
97 Wash. 504, 166 Pac. 1137;

Jorلمان v. McPhee, 31 Colo. 26, 71 Pac. 419,
422;

Kline v. Hodge, 90 Iowa 212, 57 N. W. 717;

Hoagland v. Lowe, 39 Neb. 397, 58 N. W. 197;

Patrick Land Co. v. Leavenworth, 42 Neb. 715,
60 N. W. 715;

2 Jones on Liens 44, Sec. 1457.

In *Jahn & Co. v. Mortgage Trust & Sav. Bank*, *supra*, the court used the following language, very pertinent to this case:

“If it is not conceded, we think it is proved beyond question that, at the time the contract for the construction of the building was entered into between the Simpson Company and the Coast Construction Company, it was understood by both parties to the contract that the Simpson Company was to borrow the money with which to construct the building. The arrangements for the money and for a mortgage to secure the same had already been made, and the Coast Construction Company was aware of that fact. The contract provided that \$35,000.00 of the contract price should be used in the payment of bills against the ‘building as same may be required in the progress of construction’. It is conceded that this money was so paid. The mortgage was executed on the 5th day of February, about a week after the contract was entered into. The contract provided that the balance of the \$47,000.00, after the \$35,000.00 was paid, namely \$12,000.00, was to be paid by a second mortgage for that amount. After the building was completed, materials which were furnished to the contractor, amounting to something like \$9,500.00, had not been paid for, and liens had been filed against the building. The Simpson Company refused to execute the mortgage until these lien claims were paid by the contractor. We think it is plain that the Simpson company was not required by the terms of the contract to execute the mortgage for \$12,000.00 until those lien claims were satisfied, because the con-

tract provided that it was the duty of the Coast Construction company to furnish to the Simpson company satisfactory evidence of the payment of all bills and expenses incurred in the construction and completion of the building or in connection therewith.

"We have no doubt that the mortgage of the Mortgage Trust & Savings Bank is prior to the claim of the Coast Construction Company, because the Coast Construction Company, at the time it entered into the contract, *knew that mortgage was to be given and was to be a prior lien upon the premises*. Section 1132, Rem. Code, provides, in substance, that mortgage liens filed or recorded prior to the performance of labor or the furnishing of materials are prior liens. In *Bloom on Mechanics' Liens and Building Contracts*, at Sec. 499, on page 460, it is said:

"'But where the claimant enters into a contract with the owner, and a third party takes a mortgage upon the property, and parts with value, relying upon the terms of that contract, the claimant and owner cannot change the terms of the contract to the detriment of the mortgagee, and the lien, so far as it is extended by the change of the agreement, will not take priority over the mortgagee'"

"In *Cutler v. Keller*, 88 Wash. 334, 153 Pac. 15, in referring to Rem. & Bal. Code, Sec. 1132, we said, at page 339:

"'The language of this section carried the necessary implication that the lien accorded to mechanics

and materialmen is subject to the lien of a prior mortgage on the real estate recorded prior to the commencement of the performance of the labor or the furnishing of the material, or of which the lien claimant had notice. We have uniformly so construed it.' ” (Citing a number of authorities.)

“In *Olsen v. Smith*, 84 Wash. 228, 146 Pac. 572, we said:

“ ‘Section 1132 expressly declares the mechanics’ lien a preferred lien to any incumbrance attaching subsequent to the commencement of the work for which the lien is given, and also to any incumbrance which may have attached previously to the time, and was not filed for record until after that time, of which the lien claimant has no notice.’ ”

“See also *Fitch v. Applegate*, 24 Wash. 25, 64 Pac. 147, and *Heal v. Evans Creek Coal and Coke Co.*, 71 Wash. 225, 128 Pac. 211.”

“SINCE THE COAST CONSTRUCTION COMPANY HAD ACTUAL NOTICE OF THIS MORTGAGE IT WAS BOUND BY IT, AND CANNOT NOW CLAIM THAT ITS LIEN FOR EXTRAS AND FOR THE BALANCE DUE UPON THE CONTRACT IS PRIOR TO THAT MORTGAGE.”

“Where mechanics or materialmen have notice of a mortgage which is given to secure funds to construct an improvement and know that the funds thus obtained are expended in that way, their rights are held subordinate to that of the mortgage. They

are bound by such an arrangement to the extent that funds are advanced and applied."

2 Jones on Liens 44, Sec. 1457.

"In other words, when they know that a structure upon which they are engaged has been pledged as security for advances to be applied towards its construction by a contract entered into before the work of erection was commenced, they are bound by such an arrangement, up to the extent of the funds under such contract are actually advanced and applied to construct the building."

Joralman v. McPhee, 31 Colo. 26, 71 Pac. 419-422.

A law which attempts to make a mortgage subject to subsequent liens for labor or material is unconstitutional, as said in *Meyer v. Berlandi*, 39 Minn. 438, 40 N. W. 513. "No case ever held that a mortgagor could, without the authority of the mortgagee, expressed or implied, create a lien on mortgaged property so as to give it precedence of the mortgage."

A mortgage should be construed with reference to the purposes for which it was made and objects intended to be achieved by its operation.

Brown v. Pennsylvania R. Co., 250 Fed. 513;

In re Corbitt, 248 Fed. 988.

We believe it will be conceded that the court, in interpreting this mortgage, must follow the rules laid down by the state tribunal, and we submit that under the decisions of the Supreme Court of the

State of Washington this mortgage must be held to be prior to all other liens and claims except the \$70,000.00 mortgage.

Warburton v. White, 176 U. S. 484, 44 L. Ed. 555;

Re McNeil, 13 Wallace 236, 20 L. Ed. 624;

Ellis v. Davis, 109 U. S. 485, 27 L. Ed. 1006;

Burgess v. Seligman, 107 U. S. 20, 27 L. Ed. 359;

In re Kellogg, 113 Fed. 120, 121 Fed. 333;

In re Corbitt, 248 Fed. 988.

This mortgage was not fraudulent as to any lien claimants, because they were not creditors at the time of the execution of the mortgage and had full knowledge of the purpose of the mortgage, and the mortgage itself was duly recorded.

Warren v. Moody, 122 U. S. 132, 30 L. Ed. 1108;

Adams v. Collier, 122 U. S. 382, 30 L. Ed. 1207;

Hauselt v. Harrison, 105 U. S. 401, 26 L. Ed. 1075;

In re Grocers Baking Co., 266 Fed. 900.

The trial court, in holding the invalidity of this mortgage, used the following language:

"If the \$600,000.00 long term mortgage were placed to secure a debt of a lesser amount immediately falling due, it must be held a pledging for a pre-existing debt, and void. Const. Wash. art. 12,

par. 6; *Farmers' Loan & Trust Co. v. San Diego St. Car Co.* (C. C.), 45. Fed. 518; *Kemmerer et al. v. St. Louis Blast Furnace Co. et al.*, 212 Fed. 63, 128 C. C. A. 519; *Memphis & Little Rock R. R. Co. v. Dow*, 120 U. S. 237, 7 Sup. Ct. 482, 30 L. Ed. 595; *In re Progressive Wall Paper Co.* (D. C.), 224 Fed. 143, I find no equity in the bank, or its receiver, arising out of these transactions, and hold the bank's receiver a general creditor on account of such advances."

There is nothing in the evidence to justify the statement that this mortgage was to be used as a pledge for a pre-existing debt. The mortgage was to be used for the purpose of obtaining the full \$600,000.00 due according to the terms of the mortgage. The mortgage was at no stage of the transaction used or intended to be used for the purpose of securing a pre-existing debt.

It is academic in construing a constitutional provision that the prime object is, if possible, to ascertain the purpose of the framers thereof.

The title of Article XII, Sec. 6, of the Constitution of Washington is: "Limitations upon Issuance of Stock."

That the intendment of any subdivision of a provision is not limited to itself alone, when such intendment cannot be clearly gathered without reference to the whole scheme of the provision, is also, we believe, academic and elementary.

The entire section 6, including the title, reads:

“Limitations Upon Issuance of Stock: ‘*Corporations shall not issue stock, except to bona fide subscribers therefor, or their assignees; nor shall any corporation issue any bond or other obligation for the payment of money, except for money or property received or labor done. The stock of corporations shall not be increased, except in pursuance of a general law, nor shall any law authorize the increase of stock without the consent of the person or persons holding the larger amount in value of the stock, nor without due notice of the proposed increase having been previously given in such manner as may be prescribed by law. All fictitious increase of stock or indebtedness shall be void.*”

Reading the title and the language of the section as a whole, it must be clearly apparent that the purpose of the framers of this section was to prevent the mischiefs resultant from the flooding of the market with stock and bonds or other evidences of indebtedness that do not represent anything whatever of substantial value. A prohibition against the issuing of stock, or bonds, or other obligations, except for money or property actually received or labor done, and against the fictitious increase of stock or indebtedness, to protect stockholders from speculation, and to guard the public against securities which were absolutely worthless.

Memphis and Little Rock R. R. Co. v. Dow et al., Trustees, 120 U. S. 287, 30 L. Ed. 595.

In the above case the stocks and bonds at issue were issued as security for a past indebtedness.

In *Granite Brick Co. v. Titus*, 226 Fed. 557, of case 559, Decision 568-9-10, stock was issued to secure past, present and future advances. Held valid. In this decision a general review of former Federal cases is made to the purpose of showing the intendment of the constitutional provisions in the states general is to prevent fictitious issue of stock or indebtedness.

Farmers' Loan & Trust Co. v. San Diego St. Car Co., 45 Fed. 518, cited in the decision of the court.

While there are some facts in this case which bear a striking analogy to the one at bar, yet in its general analysis this cannot be said to be true. There are marked and distinguishing features which wholly destroy its weight as an authority upon the question here at issue.

It will be noted that at a stockholders' meeting a resolution was unanimously adopted authorizing the trustees to incur a bonded indebtedness secured by mortgage for the purpose of borrowing money to be used to extend the street railroad, provide for rolling stock and equipment therefor, and to pay for labor done and to be done in the construction, maintenance and operation of said road.

The directors did not carry out those purposes. On the contrary, through various and different proceedings they individually, and not by warrant of the board of directors, contrived to and did cause

the bonds which they had caused to be issued in pursuance of such directions to be pledged for prior indebtedness to different corporations, in which they were largely interested as officers and stockers, and not a dollar thereon was realized or applied to the purposes for which the stockholders had directed the loan to be made.

Certain statutory provisions in the California code were also more or less controlling in this decision, p. 527.

In *Kimmerer v. St. Louis Blast Furnace Co.*, 212 Fed. 63, also cited, a note and bonds as collateral security were given to secure a pre-existing and past due indebtedness only. The note was for \$3,644.62. Bonds amounted to \$4,000.00 par. Four months after date of note creditor caused notes to be sold and bought in for self for \$100.00. Creditor presented claims against receiver for both amount of notes and amount of bonds. The court held the bonds invalid under constitutional provision similar to Washington.

The court said: "That no consideration whatever passed at the time the bonds were issued, and none ever has passed on account of the bond issue," hence such claim (on bonds) was fictitious, p. 65.

Court further says: "We find the whole trend of authority supporting the proposition that there must be a present consideration in order to satisfy the demands of constitutional provision."

In re Progressive Wall Paper Company, 224 Fed. 143.

The above named corporation was adjudged bankrupt, Nov. 23, 1914. In July, 1905, the Progressive Wall Paper Corporation borrowed \$11,000.00 from the First National Bank of Ballston, Spokane, and gave its promissory note therefor, which was endorsed by four of the officers of said corporation as individuals. Partial payment and renewals were made from time to time until January, 1912, when the bank held the note of the corporation due on that day for \$7,000.00. In said January, 1912, the corporation gave a renewal note for said \$7,000.00. One of the endorsers, having ceased to be a member of said corporation, refused to endorse the same and as further security the corporation delivered to said bank as collateral security seven second mortgage bonds, made by the corporation, which were secured by mortgage on its real estate and plant. Prior to this, November 1st, 1911, the directors of the corporation had passed a resolution authorizing the issuing of bonds and mortgages to secure this said indebtedness and to secure as collateral the payment of other notes of the corporation which may be given hereafter in the transaction of its business and to secure renewals.

The referee found under the constitutional provision that said bonds "had never been legally issued, and that the same were null and void", and further that such resolution was illegal in so far as it authorized the issue of said bonds as collateral

security for antecedent debts. The District Judge, in reversing this finding, after quoting the constitutional provision, in his decision says:

(1). "The corporation law of the State of New York and many recent court decisions of that state and Federal decisions, make it plain, I think, that the existence of a valid indebtedness is a sufficient consideration for a new promise or a pledge of property as security for the payment of such indebtedness. The old debt and extension of time for the payment thereof is value within the meaning of the law.

(2). In this case the bank not only extended the time for the payment of the debt by accepting the new note payable at a future day, but lost the benefit of the name and obligation of one of the indorsers to pay the debt, and accepted in lieu thereof and in consideration of the extension of time of payment the bonds in question. As stated, these bonds were a promise to pay executed by the debtor; but they were secured by mortgage upon the real estate of the debtor. This was a new and an additional security. Negotiable Instruments Law (Consol. Laws, C. 38, Sec. 51), provides:

'Value is any consideration sufficient to support a simple contract. An antecedent or pre-existing debt constitutes value, and is deemed such whether the instrument is payable on demand or at a future time.'

See language of Justice Miller, in *King v. Bowling Green Trust Co.*, 145 App. Div. 398-402, 125 N. Y. Supp. 977.

There was no fraud in this transaction. The bonds were turned over to the bank as security for the payment of the note more than four months prior to the bankruptcy, and, as stated, there was a sufficient consideration, a valuable consideration."

The case of *Memphis, etc. R. Co. vs. Dow*, 120 U. S. 287, 30 L. Ed. 595, is also cited, and we particularly invite the court's inspection and consideration of this case, which we consider fully sustains our contention with reference to this particular phase of the validity of the mortgage. The court in that case had under consideration a constitutional provision of the State of Arkansas, similar to that of the State of Washington, in which there was a prohibition against the issuance of stocks or bonds except for money or property actually received or labor done. After deciding that where it is the duty of a mortgagor to protect junior encumbrances against a prior lien and he fails to do so and they pay the amount of such lien to prevent a forced sale of the property, they are entitled to be subrogated to the right of the prior lien holders, the court used the following language:

"Recurring to the language employed in the Arkansas Constitution, we are of opinion that it does not necessarily indicate a purpose to make the validity of every issue of stock or bonds by a private

corporation depend upon the inquiry whether the money, property or labor actually received therefor was of equal value in the market with the stock or bonds so issued. It is not clear from the words used that the framers of that instrument intended to restrict private corporations — at least, when acting with the approval of their stockholders — in the exchange of their stock or bonds for money, property or labor upon such terms as they deem proper; provided, always, the transaction is a real one based upon a present consideration and having reference to legitimate corporate purposes, and is not a mere device to evade the law and accomplish that which is forbidden. We cannot suppose that the scheme whereby the appellant acquired the property, rights and privileges in question, for a given amount of its stock and bonds, falls within the prohibition of the State Constitution. The beneficial owners of such interests had the right to fix the terms upon which they would surrender those interests to the corporation of which they were to be the sole stockholders.”

It may be argued to the court that the bank and the building company were in reality one corporation, and for that reason the corporate entity of the building company should be disregarded. Without going too much into detail, we wish to state very briefly some of the evidence relative to this phase of the litigation. On June 15th, 1919, the capital stock of the bank was \$200,000.00 and there were

53 stockholders. On June 16th, 1919, the capital stock was increased to \$400,000.00, which stock was held by 189 stockholders; the trustees held only 398 shares out of a total of 4,000. On April 12th, 1920, stock was increased to \$1,000,000.00, held by 526 stockholders, and the trustees held 2,040 shares out of a total of 10,000. The stock of the building company, with the exception of a few shares, was subscribed for by O. S. Larson individually. Without the knowledge or consent of the trustees of the bank he ordered this stock executed in the name of the bank. The evidence shows that it was the intention of the building company to sell its stock on the open market to anyone who wished to purchase the same. This is even indicated in Larson's own letter.

The argument may be advanced to the effect that the building company was promoted for a fraudulent purpose by the bank, but we have pointed out to the court that the fallacy of this argument lies in the fact that the bank itself was defrauded to a greater extent than that claimed by anyone else. As we have before pointed out, the bank has nearly \$900,000.00 of its money in the property claimed by the building company, and this certainly is not evidence tending even remotely to prove fraud on the part of the bank.

We believe that the authorities that have disregarded the existence of a corporate entity have been based solely upon one of three grounds, namely:

1. On the ground of fraud or fraudulent acts.

2. Agency for parent corporation.

3. Evasion of statutory obligations.

Fletcher Enc. Corporations, Vol. 1, Sec. 44, 45, 46, sets out the three above grounds amply supported by authority. Sec. 44, entitled "FRAUDULENT ACTS", is in part as follows:

"The doctrine of corporate entity is not permitted to stand in the way of defeating fraud. It follows that it is idle to promote a corporation for the purpose of endeavoring to accomplish fraud or other illegal acts under the cloak of the corporate fiction. Where this is attempted, courts of law, equity, or bankruptcy do not hesitate to tear aside the veil of corporate entity and to look beyond it and through it at the actual and substantial beneficiary. A notable instance is found in cases where it is sought to delay, hinder, and defraud creditors by means of 'Dummy' in corporations. The courts have uniformly held that there is no magic in incorporation and refuse to apply the doctrine of corporate entity to enable such scheme to be successful."

Section 45, "AGENCY FOR PARENT CORPORATION". "The legal fiction of distinct corporate existence may also be disregarded in a case where a corporation is so organized and controlled and its affairs are so conducted, as to make it merely an instrumentality, conduit, or adjunct of another corporation. *It is not enough, however, that shareholders in the corporation are identical.* Nor is it enough that one corporation owns shares in the

other, and that they have interrelated. In order to warrant treating them as one it must further appear that they are the business conduits and the *alter ego* of one another."

Section 46, "EVASION OF STATUTORY OBLIGATION." "Where the corporate form of organization is adopted in an endeavor to evade a statute or to modify its intent, courts will disregard the corporate concept and look at the substance and reality of the matter."

The author then goes on to point out that this has been applied in cases where railroad companies have attempted to circumvent the "Commodity Clause" of the Hepburn Act by organizing dummy corporations to sell the coal owned by the railroad company.

We will briefly discuss the question of fraud, and in doing so we call the court's attention to the fact that practically all the cases are decided upon the theory that one of the corporations was used as a cloak to disguise the fraudulent acts of the other corporation. The decisions are practically uniform to the effect, as stated by Fletcher and quoted above, that "It is not enough, however, that shareholders in a corporation are identical".

Richmond & I. Const. Co. v. Richmond etc. Co.,
68 Fed. 105;

State ex rel. Tacoma v. T. R. & F. Co., 61
Wash. 507;

Pullman Palace Car Co. v. Missouri Pac. Co.,
115 U. S. 587, 29 L. Ed. 499.

Oregon Short Line R. Co. v. Postal Tel. Cable Co., 111 Fed. 842, Ninth Circuit.

The above cases also discuss the question of agency. Judge Gilbert, in the case of *Oregon Short Line R. Co. v. Postal Tel. Cable Co.*, 111 Fed. 842, used the following language in speaking of two corporations where it was claimed that *one of the corporations had no separate existence from a New York corporation, "and that all its expenses were paid and its business policies dictated by the latter; and that the sole purpose of the organization is to enable the New York corporation to exercise in the State of Idaho the right of eminent domain"*

"Its right to maintain the present suit is not abridged by the fact that the stock subscribed had not been paid for, and that the majority of the stock was owned by another corporation which conducted its business and controlled its movements. *Day v. Telegraph Co.*, 66 Md. 354, 7 Atl. 608; *Lower v. Railroad Co.*, 59 Iowa 563, 13 N. W. 718; *Kansas & T. Coal Ry. Co. v. Northwestern Coal & Mining Co.* (Mo.), 61 S. W. 864, 51 L. R. A. 936; *Exchange Bank of Macon v. Macon Const. Co.*, 97 Ga. 1, 25 S. E. 326, 33 L. R. A. 800. In the case last cited it was held that the fact that 'one corporation owns the entire capital stock of another does not vest in the former the legal title to the property of the latter, nor render the two corporations identical; on the contrary, they are separate and distinct legal entities.' "

In *Commonwealth v. Muir*, 186 S W. 194, the court said that "it is only in case of bogus or dummy corporations, where it is necessary to disregard the pretended corporations in order to circumvent fraud, that courts will ignore" the rule as to corporate entity.

In *re Watertown Paper Co.*, 219 Fed. 827, it was said: "It requires a strong case to induce a court of equity to consider two corporations as one on account of one owning all the capital stock of the other." In *Pittsburgh & Buffalo Co.*, 232 Fed. 584, 587, in denying the claim that one of the corporations involved was liable for a debt of the other the court said:

"The mere fact that the stockholders in two or more corporations are the same, or that the corporation exercises a control over the other through ownership of its stock, or through identity of its stockholders, does not make either the agent of the other, nor does it merge them into one so as to make a contract of one corporation binding upon the other, where each corporation is separately organized under a distinct charter . . . True, the legal fiction of distinct corporate existence will be disregarded when necessary to prevent fraud, or when a corporation is so organized and controlled and its affairs so conducted 'as to make it only an adjunct or instrumentality of another corporation'".

See, also, *New York Trust Co. v. Carpenter*, 250 Fed. 668.

Corsicana National Bank of Corsicana v. Johnson, 251 U. S. 6894, 64 L. Ed. 141, is a case to which we call the court's particular attention, because of the fact that Mr. Justice Pitney discussed at considerable length this question of the identity of a corporation. The facts are set forth in an opinion, in part as follows:

"A brief account of the relations between these two corporations, and of their dealings respecting the notes in question, becomes material. The loan company was organized in the month of May, 1907, under the laws of the State of Texas, with \$50,000 capital stock and with stockholders and directors identical with those of the bank. The capital of the company was subscribed for and paid out of special dividend declared by the directors of the bank for the purpose, and each stockholder had the same proportion of stock in the company as in the bank. The purpose of the new corporation, as declared in its charter, was the 'accumulation and loan of money'. Defendant testified: 'The purpose of the loan company, a state corporation, was to take such paper as the bank could not handle. It was organized by the stockholders of the bank and paid for out of the earnings of our bank. . . . The loans of the loan company were largely real estate loans. It was to help out the bank in every possible (way)'. From the organization of the company in the spring of 1907 until the spring of 1909, defendant was a director and active in the management of the com-

pany as well as of the bank. He testified that the stockholders of the two corporations were identical, and continued to be so during the entire period just mentioned; that 'whenever there was a sale of bank stock it carried with it that particular shareholders' stock in the loan company'. During the same period the two corporations had the same president, vice-president and directors, while the assistant cashier of the bank was secretary of the loan company."

Under the above statement of facts the court held that "notwithstanding the identity of stock ownership and their close affiliation and management, for some purposes, they must be regarded as separate corporations, for instance, as being capable in law of contracting with each other. See *Nashua & L. R. Corp. v. Boston & L. R. Corp.*, 136 U. S. 356, 372, 373, 375, *et seq.*, 34 L. Ed. 363, 367, 368, 10 Sup. Ct. Rep. 1004."

And in the Nashua case just cited, the court held that where two corporations have the same stockholders and their business is conducted by the same directors, the separate identity of each as a corporation is not thereby lost, and numerous cases cited therein.

It cannot be argued that the building company was the *alter ego* of the bank, because under the laws of this state the building company had no authority to engage in any part of the banking business conducted by the bank. The bank was organized under a special charter authorizing it to do a banking

business under the laws of the State of Washington, and qualified as such. On the other hand, the building company was organized for no such purpose whatever, and the question of agency is a far-fetched argument not supported by any facts in evidence.

Under no theory of corporate identity can the bank be held for the acts of the building company, but, on the contrary, contracts and business transactions between those two companies are valid contracts and transactions, and under no consideration can the debts and obligations of the building company be charged to the bank.

There was a contractual obligation on the part of the building company to place the \$600,000.00 mortgage and the directors of the bank consented to the sale of its land only upon express condition that this be done. The lien claimants knew that the money was to be raised for financing the building partly by means of this mortgage, and it must have been contemplated by all of them and known by all of them that this mortgage would be prior to their liens if the necessity arose for relying upon their lien rights. The recording of the mortgage was sufficient notice to put all of the lien claimants on inquiry, if any of them did not have actual knowledge of the facts and circumstances, and had they made inquiry they would have found a valid mortgage to the extent of \$600,000.00 given for the purpose of securing the amounts of money as needed to pay them as the

work advanced. The money was furnished and the lienors reaped the benefit thereof. What concern of theirs is it, then, in whom the benefit of this mortgage redounds? The company gave it for an honest purpose, not to secure an antecedent debt, as stated in the opinion; the mortgage was delivered to a third person for the express purpose of raising the funds and a mortgage given for that purpose is valid from its inception. "A mortgage delivered to a third person without consideration, in order that he may procure money thereon for the mortgagor, is valid in the hands of such third person's assignee for the money paid therefor by the latter, although the former fails to pay over the money to the mortgagor."

Rogart v. Stevens, 115 A. S. Rep. 627;

Thompson v. Humbolt S. & L. Co., 9 Atl. 511.

When the building company failed to place this mortgage and it was necessary to procure money to pay labor and materialmen and contractors, the bank furnished the money and took an assignment of the mortgage. It fulfilled the purpose for which the mortgage was given. From the equity standpoint, would any injustice result from the company's causing the transfer of this mortgage to one who carried out its purpose? On the other hand, would it not be inequitable to give the lienors the benefit of these advancements and allow them to deny the force of this mortgage with notice of which they became creditors? We maintain that the court of

equity will preserve all of the equities of the bank in this transaction and will apply its doctrine of subrogation, so that the equities of the bank in the entire transaction will be preserved.

“Subrogation is a device adopted or invented by equity to compel the ultimate discharge of a debt or obligation by him who in good conscience ought to pay it.”

25 R. C. L. 1312 and citations.

“It has long been a branch of equity jurisprudence. It does not owe its origin to statute or custom, but it is a creature of courts of equity, having for its basis the doing of complete and perfect justice between the parties without regard to form. It is a doctrine, therefore, which will be applied or not according to the dictates of equity, and good conscience, and considerations of public policy, and will be allowed in all cases where the equities of the case demand it. It rests upon the maxim that no one shall be enriched by another’s loss, and may be invoked whenever justice demands its application, in opposition to the technical rules of law which liberate securities with the extinguishment of the original debt. The right to it depends upon the facts and circumstances of each particular case, and to which must be applied the principles of justice . . . and the expansion of the rule has so nearly covered the field that it may now be said that, whenever a court of equity will relieve against a transaction, it will do so by the remedy of subrogation, if that be

the most efficient and complete that can be afforded."

25 R. C. L. 1313-14, and citations.

"In keeping with the more liberal application of the principles of equity, the doctrine has been greatly expanded and as now applied is broad enough to cover all cases in which one person pays an obligation which in justice and good conscience ought to have been paid by another."

25 R. C. L. 1314.

In *Memphis L. R. R. Co. v. Dow*, 120 U. S. 287, 7 S. C. 842, 30 U. S. (L. Ed.) 595, Justice Harlan says:

"The right of subrogation is not founded on contract; is enforced solely for the purpose of accomplishing the ends of substantial justice; and is independent of any contractual relations between the parties."

VALIDITY OF THE PURCHASE MONEY MORTGAGE.

We have heretofore pointed out to the court in several places in our arguments that the building company agreed to deliver to the bank \$350,000.00 worth of its mortgage bonds, the same to be part of a bond issue to be placed upon the property to assist in the construction of the building. It was understood by everybody that the building would cost in excess of one million dollars; that this \$600,000.00 would be entirely inadequate to finish the construc-

tion. The building company was to deliver these bonds within four months from the date of the agreement, pursuant to which it obtained a warranty deed to the property. The four months elapsed and the bonds were not executed or delivered as agreed, nor were they ever executed. The bank parted with its title to property conservatively valued at \$350,000.00. On the premises conveyed there was a six-story office building and the bank was occupying a portion of this building for its banking quarters. The evidence shows that it was represented to the officers of the bank that the bonds could easily be placed.

When the bank was taken over for liquidation by the State of Washington, it was found by the banking commissioner that the bank had parted with its assets, which were formerly carried in the bank's returns to the State of Washington as an asset of \$280,000.00. On ascertaining these facts the commissioner asserted his right under the transaction, and attempted to protect the interests of the creditors of the bank by asserting a purchase money mortgage.

We have argued this matter at such length it would be merely reiterating our former arguments to again discuss the equities bearing upon this transaction. We believe that the bank commissioner is entitled to have this \$350,000.00 item treated as a purchase money mortgage, and foreclosed as such to be subrogated to rights under the \$600,000.00

mortgage. It seems inequitable that the bank should be held to have lost each and every one of its equities in the property, merely by virtue of the fact that it had executed a warranty deed to the premises, when none of the terms or conditions of the contract pursuant to which it warranted title were complied with. Would it not be a travesty on justice to compel the bank to pay off a \$70,000.00 mortgage, bought by a state official in the liquidation of the bank's affairs, on the theory that he was merely performing a legal duty, and at the same time hold that the building company should be entirely exonerated from each and every one of its obligations to pay for the property and to perform those conditions and agreements which it had lawfully obligated itself to perform? We do not believe that a court of equity will permit any such results to obtain, and feel confident that the bank will be protected to the full extent of the agreement it had with the building company.

EFFECT OF ARBITRATION CLAUSE IN McCLINTIC-MARSHALL CONTRACT.

We call the court's attention to the fact that the complainant in this action does not stand in a position that commends it to a court of equity. The very apparent reason for prosecuting this action in the Federal court was an attempt to evade the rulings of the State court with reference to its arbitration agreement. The contract between the complainant

and the building company contained a valid and binding arbitration clause. It was conceded during the trial of the case, and will undoubtedly be conceded here, that the arbitration clause contained in the standard printed form prepared by the McClintic-Marshall Company was a binding and enforceable obligation in both the States of Pennsylvania and Washington. We will, therefore, cite no authorities from either of those two states. A controversy arose over several items involved in the contract, the building company refusing to pay certain amounts due owing to said breaches. McClintic-Marshall Company could not enforce its lien in the state courts of the State of Washington, without complying with the arbitration clause. In fact, it seeks to prosecute its action in the expectation that it may prevail upon the Federal Courts to excuse it from compliance with its arbitration agreement. A court of equity will not permit a party to select its own forum, but will restrain the citizens of another state from attempting to avoid the obligations of its contract by resorting to a selected forum. We call the court's attention to the following case:

Cole v. Cunningham, 133 U. S. 107, 23 L. Ed. 538.

We therefore submit that the complainant is without any right in equity to prosecute its foreclosure proceedings, and the court erred in permit-

ting the claim of the complainant to be adjudged prior to that of any of the mortgages in controversy.

EFFECT OF LIEN WAIVERS.

The contracts of the Tacoma Millwork Supply Co., E. E. Davis & Co., Edward Miller Cornice and Roofing Co., Ben Olson Co. and other lien claimants had valid and binding waivers of lien claims and agreements not to file lien claims. This was done, as we before indicated, for the purpose of permitting the \$600,000.00 mortgage to be placed upon the premises prior to any lien claims. Such an agreement was valid and binding.

Holm v. C. M. & P. S. Ry. Co., 59 Wash. 293.

The lien claimants seek to avoid the effect of their lien waivers, nevertheless elected in open court to treat their contracts as entire and indivisible. In other words, seeking to secure their rights under their contract and still avoid that portion of the contract in which they expressly waived their liens. This procedure cannot be sustained. There were no misrepresentations shown in the evidence sufficient to justify a finding that the representations were fraudulently made. They were not made with any intention to deceive the lien claimants, but were made honestly and in the full belief that they were true. Inasmuch as the receiver has appealed from this portion of the decree we do not wish to further argue the matter, relying upon the decision of the

court in the receiver's appeal. We wish merely to state, in this argument, that the lien claimants who agreed to waive their liens did so for the express purpose of protecting the \$600,000.00 mortgage in controversy, and it would be inequitable to now subject that mortgage to the liens referred to.

In concluding this brief, we submit that a marshalling of the equities incident to the entire transaction demands that both of the mortgages be declared valid and prior to all other lien claims; that the \$70,000.00 mortgage be decreed a first and prior lien and that the bank should not be relegated to the status of a mere general creditor, or worse.

Respectfully submitted,

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